Canada-United States Law Journal

Volume 11 | Issue Article 23

January 1986

U.S. Tax Aspects of Technology Transfers between the United States and Canada

George G. Goodrich

U.S. Tax Aspects of Technology Transfers Between The United States and Canada

*by George G. Goodrich**

Over the past two hundred years, substantial technology, generally referred to as intangible or intellectual property, has been acquired and developed within the United States. While the development and usage of this technology has contributed to the dramatic growth of the United States over this period of time, it generally has contributed to the growth and development of many other nations as well, since the United States has exported intellectual property throughout the World through various means.

Regardless of the form of the intangible property or its method of transfer, the United States has continued to tax the revenue, either hypothetical or actual, and has continued to amend its laws over the years in order to insure that it receives fair remuneration for the use of this property.

I. Intellectual Property—Definitions

While a legal definition of the various forms of intellectual property may require greater elaboration in order to be more precise, for purposes of this review, intellectual property capable of being transferred, and which is specifically covered by the U.S. tax laws, generally includes the following:

- Patents: Governmental grants securing exclusive right to an invention or process.
- Trade secrets (Know-how): Generally, industrial property rights to a process or method for production or development exclusive to the producer, or the knowledge or understanding of certain processes or methods if in production.
- Trademarks: a design or device that indicates exclusive origin or ownership of property.
- Trade Names: the name that distinguishes a product or entity from others.
- Software: computer programs and procedures associated with a particular system.

* Certified Public Accountant and Senior Tax Partner of Arthur Andersen & Co. (Cleveland, Ohio).

— Copyrights: the sole, exclusive right to publish, reproduce or sell musical, literary or artistic compositions.

Generally, the above possess an intrinsic value exclusive to the owner of the property.

II. U.S. Tax Incentives for the Development of Intellectual Property

The U.S. federal income tax laws, including the numerous revisions and amendments over the years, contain provisions designed to specifically address the need to develop intellectual property. These provisions include:

— § 162—deduction allowed for all ordinary and necessary business expenses incurred in a trade or business versus capitalization of costs of developing an asset.

— § 177—capitalization and amortization of trademark expenditures.

— § 174—deduction for all research and development expenditures.

— § 30—credit against federal taxes for research and development expenditures.

§ 1.861-8—moratorium on allocation of research and development expenditures against foreign source income.

§ 925—Foreign Sales Corporation benefits which may be available in connection with the transfer of certain intellectual property.

III. Forms of Transfers of Intellectual Property

Transfers of technology abroad may take various forms, both intended and unintended. As a result, the U.S. federal income tax treatment of such transfer may vary, again, as intended or as unintended, as follows:

A. License Agreements:

Generally, the authorization of another entity *to use* the intellectual property for a fee.

— Exclusive right to property

— Limited in time or geographic area

The fee may be a fixed amount, or a variable, dependent generally upon production.

B. Sale of Technology:

Generally, the *complete transfer* of intellectual property to another legal entity for payment. Payment may or may not be contingent on future use or disposition of the intellectual property.

— Transfer is unlimited as to time or use.

— Exclusive right to property.

C. Contribution of Intellectual Property to Another Legal Entity:

The transfer is made in exchange for ownership in the other legal entity. Control may or may not be obtained through such transfer.

D. Agreement to Provide Training On a Cost Basis:

The transfer, through training, of certain intellectual property such as know-how or trade secrets.

E. Cost-sharing Arrangements:

— Cost of research and development of intellectual property shared by two or more legal entities in proportion to the anticipated future benefit.

— Rights to the intellectual property rest in all parties to the cost-sharing agreement.

IV. U.S. TAS ASPECTS OF INTELLECTUAL PROPERTY TRANSFERS—OVERVIEW

The U.S. taxes its citizens and residents on a world-wide basis. Therefore, it attempts to tax intellectual property developed in the U.S. while it is used in the U.S., and after it has been transferred abroad.

The U.S. federal income tax consequences of the outbound transfer of intellectual property may be summarized as follows:

1. A license arrangement, such as a royalty fee, where the licensee is limited in some fashion, is generally taxed in the U.S. as ordinary income.
2. Where the transferee is related to the transferor, that is, the transferor owns more than 50% of the stock of the transferee, the income will be taxed at ordinary rates, notwithstanding the transfer of exclusive rights.
3. Contribution to capital:
   a. Generally to be taxed to the transferor *as if* payment had been received on an installment basis.
   b. If the contribution is to a minority-owned company, the transfer may be subject to an excise tax.
4. Depending upon the source of the income from the technology transfer, foreign taxes imposed upon the transfers may be creditable in the U.S.
5. In the case of deemed payment, the transferee will be allowed a reduction in earnings and profits.
6. U.S. export incentives, such as Foreign Sales Corporations, may be used to cause transfers of specific technology to be virtually tax free.

V. U.S. Tax Aspects of Intellectual Property Transfers—Discussion

Where a transfer of intellectual property from a U.S. resident to a foreign entity is in the form of a negotiated license arrangement, numerous U.S. tax rules come into play in determining the amount of income to be taxed, the source of the income, and the character of the income.

A. Amount of Income

The amount of income to be taxed will generally be the amount specified in the license agreement. Since the license agreement will normally have been negotiated, there is a presumption that the parties have agreed to the appropriate remuneration for the rights that have been transferred.

However, if the Internal Revenue Service concludes that the parties to the license agreement did not operate at arms length in negotiating the license agreement, such as in the case of a U.S. parent company dealing with a controlled Canadian subsidiary, it will generally consider proposing an adjustment to the income being reported by the U.S. parent company, pursuant to § 482.

Although the recent history of intercompany transactions between U.S. and Canadian companies has indicated that the primary thrust of the attack by both the IRS and Revenue Canada has been in the area of intercompany pricing, the focus of attention previously was on appropriate royalty rates. Due to the significant cross-border activity between the U.S. and Canada, there is significant experience in dealing with this type of issue. The IRS, in various releases dealing with the subject of valuation of intangibles, has indicated the following:

1. The actual or prospective income factor takes precedence over any other factor in valuing intangibles.
2. Patent valuations are founded directly on earning power.

Generally, the approach taken by the IRS in auditing such issues has been as follows:

1. Recommend a rate that the transferor may be charging to the transferees, particularly if they are unrelated to the transferor.
2. Recommend a rate used by competitors.
3. Develop a formula rate based upon an expected return.

Obviously, the hindsight afforded the IRS in challenging the appropriateness of royalty rates has left many multinationals vulnerable to significant unplanned income adjustments upon audit. However, through enforcement of the mutual agreement procedures of the U.S.-Canada Income Tax Treaty, the competent authorities of the respective countries generally have been able to resolve these controversies to the point that, even if there is an appropriate adjustment to the income of the respective parties, it generally will not result in economic double taxation.

A second factor to be considered in determining the amount to be taxed in the U.S. is the application of Regulation § 1.861-8 to the determination of the net foreign source income for purposes of calculating allowable foreign tax credit. While this Regulation initially required the allocation of research and development expenses to foreign source royalty payments, a moratorium was placed on this allocation since the requirement was deemed to inhibit the development and exporting of U.S. technology. That moratorium, although scheduled to expire through amendments under the Tax Reform Act of 1984, continues to be in effect.

A third factor in determining the amount of royalty income is the elective treatment of Canadian taxes withheld. Generally, a Canadian payor of royalties will be required to withhold 25% of each payment in satisfaction of the Canadian tax liabilities (reduced to 10% in the case of a U.S. recipient). The U.S. recipient may either treat such withheld amounts as deductible taxes pursuant to § 164 of the Internal Revenue Code, or as credits allowable pursuant to § 901 as an offset to the U.S. mainstream tax on a dollar-for-dollar basis, subject to certain formula limitations of § 904.

B. Source of Income

The source of the income is relevant to the recipient in determining the foreign tax credits limitation under § 904. Generally, amounts paid from a foreign source will be treated as foreign source income and therefore become a factor in the determination of allowable foreign tax credits. For instance, pursuant to § 862(a)(4), royalties for the use of patents, trademarks and copyrights outside the United States are foreign source income. Therefore, determining the source of such amounts received depends solely upon the place of use.

Furthermore, payments received for the use of know-how will generally have its source determined according to the place of use. The technical services, however, will depend upon the place where the services are rendered, not by the location of the payor.

C. Character of Income

A traditional license arrangement permitting the licensee to use the technology will result in the income being taxed as ordinary income, an arrangement which transfers all substantial rights to the technology. Generally, this will be treated, for U.S. tax purposes, as a sale of a capital asset, with the income being taxed at favorable capital gains rates. Generally, a sale will have taken place where, in the case of patents, trademarks and know-how, the transferor grants exclusive rights to the transferee, even though the use is restricted to a particular geographic area. For copyrights, the transferor must grant exclusive rights to the copyright work for the entire life of the copyright.

While the sale of technology will generally result in capital gain treatment, the income (gain) will be classified as ordinary income in the case of a transfer to a foreign corporation controlled by the U.S. transferor pursuant to § 1249.

D. Personal Holding Company Status

One of the federal income tax traps for the unwary in dealing with the development of technology and the exporting of technology is the potential for personal holding company status of the U.S. company for the generation of foreign personal holding company income in a foreign entity.

Specifically, § 541 of the Internal Revenue Code imposes a personal holding company tax on the undistributed personal holding company income of companies that fall within the ownership and income tests of § 542.

It is clear that amounts received for patent royalties, and, under certain circumstances, copyright royalties, constitute personal holding company income. Therefore, in many instances, start-up companies that have developed technology and are selling and/or licensing that technology, both domestically and abroad, could be personal holding companies. Such companies would be subject to the imposition of the penalty tax for the failure to distribute personal holding company income, particularly where the sales are made with the seller retaining protected rights.

Many multinational companies have foreign subsidiaries which constitute the international licensing entity for the multinational group. Where the licensing subsidiary is a controlled foreign corporation, that income from the licensing activity will most likely be considered as foreign personal holding company income, as defined in § 954(c); therefore, the income is potentially deemed taxable back to the U.S. parent, whether or not actually distributed, as Subpart F income.

E. Contributions to Capital

Perhaps the most elusive area of the U.S. tax law in focusing on the treatment afforded technology transfers is that dealing with transfers to controlled foreign corporations as contributions to capital or in certain corporate reorganizations. This specific issue has been the subject of considerable legislation over the years, as well as several revenue procedures aimed at providing guidance in the area.

Prior to the Tax Reform Act of 1984, § 367 of the Internal Revenue Code, required that outbound transfers of intangible property were subject to a "toll charge" unless the transferor obtained a prior ruling from the Internal Revenue Service to the effect that the transfers were not pursuant to a plan where one of the principal purposes was the avoidance of federal income taxes. Section 367 was amended by the Tax Reform Act of 1984 to eliminate this ruling requirement. In its place, § 367(d) is not

the operative section to control the treatment of the transfer of certain intangible property and, in general, provides that a U.S. transferor is to be treated as having sold the intangible property for payments which are contingent upon the productivity, use, or disposition of such property. Payment for the transferred property will be deemed to have been received on an annual basis over the useful life of the property in amounts that would be comparable to what would have been received on an actual sale of the property. In summary, outbound transfers of intangible property are removed from the general "automatic toll charge" rule and instead are subjected to the "deemed income" rule of § 367(d).

While the transferor will be required to recognize income annually as if the intangible property were sold for a contingent annual payment over the useful life of the property, and in the case of a disposition following the transfer, a contingent payment at the time of the disposition of the intangible by the transferee, all such income will be recognized as U.S. source ordinary income. This complex set of rules can be summarized as follows:

1. Intangibles Retained by the Transferee.

Where the transferred intangibles are not disposed of by the transferee following the transfer, the income to the transferor is in equal amounts which reasonably reflect the amounts that would have been received annually in the form of payments contingent upon the productivity, use or disposition of such property.

The phrase "amounts which would have been received" may be difficult to define in many cases due to the problem of quantifying a transaction which never took place. However, in the determination of an "arm's-length" rate under § 482—as applicable to the transfer or use of intangible property—the rate to be used ordinarily will be the rate paid by an unrelated party for the same intangible property under the same circumstances. In the absence of similar representative transactions involving unrelated parties, the Regulations list various other factors which may be considered in determining an arm's-length rate:

a. The prevailing rates in the same industry or similar property,
b. The offers of competing transferors or the bids of competing transferees,
c. The terms of the transfer, including limitations on the geographic area covered and the exclusive or nonexclusive character of any rights granted,
d. The uniqueness of the property and the period for which it is likely to remain unique,
e. The degree and duration of protection afforded to the property under the laws of the relevant countries,
f. The value of services rendered by the transferor to the transferee in connection with the transfer,
g. Prospective profits to be realized or costs to be saved by the

transferee through its use or subsequent transfer of the property,

h. The capital investment and starting-up expenses required of the transferee,

i. The availability of substitutes for the property transferred,

j. The costs incurred by the transferor in developing the property, and

k. Any other fact or circumstance which unrelated parties would have been likely to consider in determining the amount of an arm's-length consideration for the property.

Whether the Regulations under the new law adopt the factors used in § 482 remains to be seen; however, a less strict approach may eventually be used in the determination of the "amounts which would have been received" since the new law uses the term "reasonably reflect" in determining such amount.

It should be noted that this treatment, while new as a result of the Tax Reform Act of 1984, is not totally unexpected. Several private letter rulings in the late 1970's and early 1980's concluded that while a transfer was tax free under § 367, income was reallocated under § 482.

Another point clarified by the Regulations relates to the duration of the deemed payments. The new law provides that the deemed payments must be included in the transferor's income "annually . . . over the useful life" of the transferred intangibles. The concern, and therefore the need for clarification, arises since some intangibles have indefinite useful lives. In addition, there may be a conflict between the "useful life" and the "statutory life."

As a result of the "useful life" measure, the amount of the annual § 367(d) deemed income in many cases will exceed the amount that formerly would have been imposed as a tainted asset toll charge under the Rev. Proc. 68-23 Guidelines (or that would have been includable in the case of an outright sale of the intangibles). The amounts to be included in income must reflect not only the value of the intangibles at the time of transfer (as under the IRS Guidelines) but also their future value, which could increase substantially (e.g., as the transferee's business becomes increasingly profitable) over the useful lives of the intangibles. Therefore, taxpayers must be aware of the fact that § 367(d) could also require a "revaluation" of the transferred intangibles at the end of each successive year following the year of transfer in order to establish the appropriate amount to be included in income for such year.

2. Intangibles Disposed of by the Transferee.

Section 367(d) also provides that the amount to be included in income by the transferor in the case of a disposition (whether direct or indirect) of the transferred intangibles by the transferor, following the transfer, is the amount that reasonably reflects the amount which would

have been included in income at the time of the disposition, as if the original transferor had sold the intangibles.

3. The Conference Report.

The Conference Report points out that the amount of the deemed income in the case of such a post-transfer disposition will depend on the value of the intangible at the time of the second transfer. Therefore, even after including annual toll charges in income, the "disposition" toll charge will also have to be included in the income of the original transferor, resulting in a total income recognition by the original transferor in excess of the value of the intangibles at the time of the original transfer.

The Conference Report provides that a disposition of the intangible will be considered to have occurred when (1) the transferred intangible is disposed of by the transferee corporation, or (2) the transferor's interest in the transferee corporation is disposed of.

IV. Other Tax Attributes of the Intangibles Toll Charge

A. Source and Character

As explained above, the amount of any intangibles deemed income under § 367(d) that is included in income is to be treated as U.S. source ordinary income. As a result, the amount of the deemed income will be includable in the denominator but not the numerator of the § 904(a) foreign tax credit limitation fraction. Thus, in addition to imputing taxable income to the transferor, § 307(d) may also operate to reduce the amount of foreign tax credits that can currently be claimed against the transferor's U.S. tax liability (e.g., where the transferor is in or near an excess credit position).

By contrast, if the intangibles were licensed instead of being transferred in exchange for stock, the royalty payments generally would be treated as foreign source income to the transferor. Similarly, if the intangibles were sold outright to the transferee, the gain or income recognized on the sale might have been treated as foreign source income if the normal title passage rules dictated such treatment. Thus, given the potentially costly results of U.S. source income treatment, it is anticipated that in many cases, taxpayers will choose the licensing or outright sale alternative over a transfer in exchange for stock to the extent the intangibles involved fall under § 367(d).

B. Earnings and Profits Effect

Section 367(d) provides that the earnings and profits of the transferee foreign corporation are to be reduced by the amount of any "toll charge" included in income by the transferor. This adjustment is intended to place the transferee in the same position it would have been in

had it actually made the deemed "payment" included in the transferor's income.

The earnings and profit adjustment will have an effect on future dividends or on Subpart F income, of the transferee, since the taxability to the transferee's U.S. shareholders is generally limited by the amount of the transferee's Earnings and Profit amount. However, to the extent the transferee is less than 100% owned by the transferor, the benefits of such adjustment to the transferor will be reduced proportionately.

C. Basis Effect

Neither the statute nor the Committee Reports contain any indication as to the intended basis consequences of the § 367(d) toll charge. However, since § 367(d) does not alter the nature of the underlying transactions under §§ 351 and 361, and since the § 367(d) toll charge is treated as ordinary income rather than as a capital gain, it would appear that neither the transferee's basis in the intangibles nor the transferor's basis in the stock is affected by the toll charge. Hopefully, the Regulations will clarify this point.

D. Relationship to § 482 Adjustments

The Senate Report provides that the special rules relating to transfers of intangibles (including the sourcing rule) apply only to situations involving a transfer of the intangible property to a foreign corporation, not a sale or licensing arrangement. In any case in which the IRS determines that an adjustment under § 482 is appropriate, for example, because a foreign corporation obtained the use of the intangible property without sufficient compensation, the special rule for transfer of intangibles will have no application to amounts included in income of the U.S. taxpayer pursuant to such an adjustment. Thus, for example, the source of any adjustment to the income of a U.S. taxpayer under § 482 would be determined without regard to the sourcing rule of § 367(d).

E. Active Trade or Business Test of § 367(a)

The treatment described above for transfers of intangible property pursuant to § 367(d) is an exception to the general rule under § 367(a) where the transfer of property to a foreign corporation will be tax free if it is used in the active trade or business of the foreign company. The special rule contained in § 367(d) appears to be inconsistent with Congress intent that certain types of intangible property be subject to the active trade or business test of § 367(a). Specifically, legislative history indicates that the purpose of § 367(d) was, in effect, to introduce a recapture rule where a U.S. developer of technology who had enjoyed certain U.S. tax benefits during the development stage could require that those benefits be recaptured upon the exporting of the technology abroad. The specific incentives and benefits contemplated in the legislative history are

those noted above authorizing the current deduction for research and development expenditures pursuant to § 174, the special credit for qualified research expenses under § 30 and the exclusion of research and development expenditures from the application of Regulation § 1.861-8. This rule would appear to encompass virtually all intangible property. Those which are generally covered by the above Internal Revenue Code sections include patents, formulas, know-how, trade secrets and the like that are generally considered to be a type of technology related to the manufacturing process.

On the other hand, the legislative history supports the fact that transfers of goodwill or going concern value as well as transfers of marketing intangibles such as trademarks or trade names, would not be subject to the special rule of § 367(d). Instead, these should be tested under the provisions of § 367(a). Thus, the transfer will be tax free to the extent that those intangibles will be used in an active trade or business in the foreign location.

F. Excise Tax

While there has been much discussion of the treatment of the newly-enacted § 367(d), an often overlooked provision of the law which may be applicable in comparable situations is § 1491. Section 1491 imposes a 35% excise tax on the transfer of appreciated property under certain circumstances; specifically, where a U.S. taxpayer transfers appreciated property to a foreign partnership or a non-controlled foreign entity, § 1491 will generally cause an excise tax of 35% to be imposed upon the appreciation in value of the property transferred. This excise tax can be avoided if the U.S. transferor agrees to the application of rules similar to those set forth under § 367.

The above statement indicates the uncertain environment in which U.S. taxpayers must operate with respect to transfers abroad. Consequently, since the Regulations have not been issued under § 367, it is unclear at this time how a transferor can avoid the application of § 1491.

G. Transfers of Computers

An area of particular concern at this time with the advent of advanced utilization of computer software both in the United States and abroad, is the tax treatment applied to transfers of computer software. Obviously, for purposes of this discussion, computer software should be treated as technology which is available for transfer. As to whether or not the technology is that contemplated by § 367(a) as technology which is tangible personal property or technology which is contemplated by § 367(d) which is intangible property, is uncertain. It is arguable that one may look to other Code sections for guidance in this area. For instance, in GCM 39449 dated November 25, 1985, it is clear that certain computer software qualifies as "export property" under § 993(c). This

same language has been adopted in § 925 of the FSC provisions. While the GCM cited indicates that export property does not include patents, inventions and other like property, it does imply that computer software could be treated like copyrighted property, although a copyright itself is excluded from the definition of export property. The analogy to be drawn from the above is that computer software may very well qualify as intangible property transferred under § 367(d).

In conclusion, the enactment of § 367(d) and the purported relaxing of the rules of § 367(a) have led to significant uncertainty in the area of transfers of intangible property. This uncertainty may be clarified upon the issuance of final Regulations; however, until that date, U.S. taxpayers are faced with resolving the dilemma by continuing to utilize generally-accepted business practices.

1. There will be a significant impairment in the value of the property to a foreign manufacturer because of his inability to accumulate profits either due to the deemed payment requirements or through a license agreement.
2. The foreign country may not permit a tax deduction for the deemed royalties.
3. The sourcing of the deemed royalties as U.S. source income will restrict the utilization of foreign tax credits.
4. The imputed value assigned to the deemed royalties will obviously result in significant controversies both with the Internal Revenue Service as well as tax authorities in a foreign country. In many cases, these controversies may be resolved through the Competent Authority mechanism contained in an income tax treaty such as that which exists between the U.S. and Canada. However, in many cases, such as with Brazil and Mexico, such a mechanism does not exist and the U.S. taxpayer must evaluate alternative means of transferring technology.
5. An agreement to provide continuing technology or the right to updates will cause significant uncertainty as to the appropriate tax treatment.

VII. Suggestions for Coping with Adverse Tax Implications

Some alternatives to the above would include an outright sale of the property, outright licensing or entering into cost-sharing arrangements:

A. Sale of Intangibles

Since § 367(d) only applies to property transfers pursuant to § 351 and § 361, an outright sale of the property would avoid the uncertainty associated with the tax free transfer. The rules governing the sale of the property have been discussed above, specifically as to whether or not the gain would be treated as ordinary income or as long-term capital gain. The difficulty associated with an outright sale will be the requirement to determine a value of the intangible and the up-front payment of tax. On the other hand, this will avoid the annual controversy over the value of

the deemed royalties, particularly if the Regulations, when issued, require an annual determination and where the foreign transferee is benefiting from a significant increase in the value of the technology transferred. The more value expected to be added by the transferee, the more attractive a front-end sale becomes as a viable alternative.

B. Licensing

As an alternative to an outright transfer of the property pursuant to § 351, the U.S. company could license the foreign entity through a standard license agreement providing for an annual royalty. To the extent that the royalty payment meets the arm's-length test, this would avoid the annual controversies with the Internal Revenue Service and the uncertainty as to potential deemed values associated with the transferred technology. In addition, the income from the royalty would be treated as foreign source income which should benefit the U.S. taxpayer in connection with the utilization of foreign tax credits.

C. Cost-sharing arrangement

An additional alternative to transferring the technology pursuant to § 351 and therefore being subject to the provisions of § 367(d), is the entering into of cost-sharing arrangements between the U.S. parent and the foreign subsidiary with respect to the development of intangible property. Pursuant to a cost-sharing arrangement, all of the parties sharing in the costs will be treated as having acquired a proprietary interest in the intangible property. Therefore, no allocation of benefits or deemed benefits need be made in cases where either party utilizes the technology in its trade or business. The advantages and disadvantages of entering into cost-sharing arrangements are generally related solely to economic business considerations. Particularly, such considerations include whether or not a foreign entity will want to obligate itself for expenditures for technology which could end up being well beyond its economic means to fund.

VIII. Reform

There are various areas of proposed reform that will affect the U.S. exporters of technology.

The first area involves President Reagan's recent attempt to amend patent laws to provide worldwide protection for U.S. inventors. With the pirating of technology, trademarks and the like, this area is bound to receive immediate attention and approval.

In the area of U.S. tax reform, it is premature to speculate what the nature of the legislation might be. Many project that the provisions of House Bill 3838 are likely to pass in their present form. While the changes are restrictive in nature, they have not to date been controversial. Therefore, there is little sympathy in Congress for protecting the

interest of the multinationals. Specific proposals, to date, include the following:

A. Trademarks/Tradenames.
The current election to amortize the costs of obtaining trademarks and tradenames over a five-year period would be repealed. Such costs would be capitalized and recovered upon disposition.

B. Sale of Intangible Property—Source of Income.
   1. Income sourced where intangible is used.

C. Foreign Tax Credit Limitations.
   1. President's proposal—adopt 'per country' limitation.
   2. Separate limitations for different classes of income.
      a. Banking and insurance
      b. Shipping
      c. Foreign currency and translation gains
      d. Passive income

D. Transfers of Intangibles to Related Parties.
   1. Payments must be commensurate with income attributable to the intangible property transferred.
   2. Deemed income must be determined under the same standard.

IX. CONCLUSION

From a businessman's perspective, there is a natural free flow of technology and other intangibles between the U.S. and Canada. Obviously, these exchanges have contributed to the significant economic growth of both countries.

The tax structure of each country provides for a watchdog to insure that all parties operate on an arm's-length basis. On the other hand, the mutual agreement procedures of the Income Tax Treaty between the U.S. and Canada provide a relief mechanism to avoid double taxation of the respective parties to a transaction.

However, as a final point, taxpayers have been placed in a precarious position, through the enactment of § 367(d), of not being able to quantify the income tax consequences of a transfer of intangibles. Obviously, sound business practices dictate that a taxpayer not act when in doubt. Accordingly, until this area is clarified, the existence of these laws may inhibit the normal free flow of technology.

In any event, it is clear that no one should transfer technology without first obtaining the advice of tax counsel.