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Annex 3: Definition of 'Tax' in US Law

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Annex 3.

Definition of "tax" in US law

Reuven Avi-Yonah

Under US law, a tax is defined as "a compulsory payment pursuant to the authority of a foreign country to levy taxes".¹ While this definition is somewhat circular, it does require (i) a payment, (ii) that is not voluntary, (iii) to a foreign country, (iv) pursuant to its authority to levy taxes. The requirement that a payment is made means that the taxpayer must prove that it paid or accrued the tax and may not receive a refund of the tax it paid.² The requirement that the payment is not voluntary means that the taxpayer is obligated to exhaust "all effective and practical remedies" to reduce its tax liabilities; and a remedy is effective and practical if its costs are reasonable in light of the amount at issue and the likelihood of success.³ The requirement of payment to a foreign country distinguishes payments to private parties (e.g., tithes). The requirement that the payment be made pursuant to the authority to levy taxes distinguishes a tax from a penalty, a fine, or a customs duty.⁴

The most difficult distinction in the definition is another requirement, which was added to distinguish a tax from a royalty paid in exchange for the right to extract mineral resources like oil.⁵ Under the regulations, a payment to a foreign country is not a tax "to the extent a person subject to the levy receives (or will receive), directly or indirectly, a specific economic benefit... from the foreign country in exchange for payment pursuant to the levy."⁶ "Specific economic benefit" is defined as "an economic benefit that is not made available on substantially the same terms to substantially all persons who are subject to the income tax that is generally imposed by the foreign country... Thus, a concession to extract government-owned petroleum is a specific economic benefit, but the right to travel or to ship freight on a government-owned airline is not because the latter, but not the former, is made generally available on substantially the same terms."⁷ This additional requirement has been criticized by commentators.⁸

1. Treas. Reg. 1.901-2(a)(2)(i).

2. Treas. Reg. 1.901-2(e)(2) (payment is not a tax if it is reasonably certain that the amount paid will be refunded). See, e.g., Rev. Rul. 78-258, 1978-1 CB 239 (a Brazilian withholding tax that was refunded to the taxpayer was not creditable. See also Treas. Reg. 1.901-2(e)(3) (taxpayer may not receive the tax back as a subsidy).

3. Treas. Reg. 1.901-2(e)(5).

4. Treas. Reg. 1.901-2(a)(2)(i).

5. See Rev. Rul. 76-215, 1976-1 CB 194; Rev. Rul. 78-222, 1978-1 CB 232. See generally Joseph Isenbergh, *The Foreign Tax Credit: Royalties, Subsidies, and Creditable Taxes*, 39 *Tax L Rev* 227 (1984).

6. Treas. Reg. 1.901-2(a)(2)(i).

7. Treas. Reg. 1.901-2(a)(2)(ii)(B).

8. See Isenbergh, *supra*.