

IRS: Certain US Depositary Receipt Program Payments Are US Source Income

1 March 2023

Report from our correspondent Rubens Biselli

On 24 February 2023, the Office of Chief Counsel of the Internal Revenue Service (IRS) issued a memorandum ([AM 2023-001](#)) examining the character and source of income with respect to payments made by a US depositary institution to a foreign corporation for expenses incurred to institute an American Depositary Receipts (ADR) Program and pursuant to a revenue-sharing arrangement (see Note).

The IRS stated that the exclusivity of the US depositary institution to establish, control and exploit the trading of the ADRs constitutes a property right under [Section 861](#) of the Internal Revenue Code (IRC). The memorandum recognizes that the intangible property in question is not protected under a US statutory regime, but, based on *Sabatini v. Commissioner*, 98 F.2d 753(2d Cir. 1938), it argued that the source of an intangible property income is the place where the person has an exclusive contractual right and the income should be assigned to the place of restraint that is "most important to the income earning process."

Accordingly, the United States is the location of the capital markets that the US bank is accessing to profit from trading in the ADRs, regardless of whether the holders of the ADRs are in the United States or not, considering that the amount paid by the depositary institution to the foreign company is not contingent on the location of the holders of the ADRs.

Consequently, by treating the payments under the ADR program, whether the reimbursement of expenses or the share of revenue, as US source income, the IRS concluded that such payments are subject to US withholding tax at a 30% rate under sections [1441](#) and [1442](#) of the IRC. The US withholding rates may be reduced or eliminated under a US income tax treaty or if the income is effectively connected with a US trade or business.

Note: ADR Programs are jointly established by a foreign company and a US bank, with the bank often paying a portion of the company's expenses or sharing revenue with the foreign company in exchange for the exclusive right to trade its ADRs.

