

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

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Refer Reply To:  
CC:INTL:Br3-PLR-115040-00  
Date:  
December 7, 2000

In Re:

Legend:

Taxpayer =

Business X =

Date A =

Customer =

Dear :

This is in response to your letter dated July 18, 2000, requesting a ruling that the Bulgarian withholding tax described in Article 34(4) of the Bulgarian Corporate Income Tax Act ("BCITA") imposed on certain income that is not derived from a permanent establishment ("Bulgarian Withholding Tax") qualifies as a tax in lieu of a tax on income under section 903 of the Internal Revenue Code ("Code").

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for this ruling, all of the information submitted is subject to verification on examination. Further, our analysis and conclusion is based upon a certified English translation of the BCITA, as promulgated in Bulgaria's State Gazette No. 115 on May 12, 1997, and as amended in 1998 and 1999. Subsequent amendments to the BCITA may change our analysis and conclusion with respect to the Bulgarian Withholding Tax for affected years. This ruling is conditioned on the accuracy of the translation as provided by the Taxpayer. The Internal Revenue Service has made no independent verification of the accuracy of the translation of the foreign law supplied. The information submitted for consideration is summarized below.

Taxpayer, a United States subchapter S corporation, develops and implements standardized computer software for customers engaged in Business X. Taxpayer developed a software application ("software") which it licenses worldwide. In connection with licensing its software, Taxpayer provides implementation-related

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technical services and support to software licensees.

On Date A, Taxpayer entered into a multi-year License and Implementation Agreement (“Agreement”) with Customer, a Bulgarian company engaged in Business X and headquartered in Sofia, Bulgaria. Pursuant to the terms of the Agreement, Customer acquired a nonexclusive license to use Taxpayer’s software for Business X purposes, including rights to software operating manuals, future modifications, enhancements, supplements, and alterations to the software. Taxpayer agreed to assist Customer in the selection, installation, and certification of the hardware, system software, software security, third-party software, telecommunications, and operational procedures. Finally, throughout the term of the Agreement, Taxpayer is obligated to support the most recent upgrades to the software, making U.S. personnel available for telephone consultation or computer-to-computer diagnosis at all times. Taxpayer will implement the software in three phases over an 18-24 month period. During the implementation, Taxpayer’s employees will conduct all software-related activities within Customer’s facilities.

Taxpayer represents that pursuant to the Agreement, Customer will pay to Taxpayer amounts in the form of royalties and consideration for technical services that will be subject to the Bulgarian Withholding Tax. Taxpayer further represents that: (1) Bulgaria, under Articles 3(2) and 6(1) of the BCITA, has a tax on realized net income that is generally imposed on Bulgarian taxpayers, including foreign persons doing business in Bulgaria; and (2) Taxpayer will not be subject to such Bulgarian tax on realized net income because Taxpayer will not be engaged in business activities in Bulgaria.

Certain entities are subject to the Bulgarian Withholding Tax with respect to income (e.g., royalties and income from technical services) that “is not derived from a permanent establishment.” BCITA Art. 34(4). Article 12(2) of the BCITA provides that the base for the Bulgarian Withholding Tax is the gross amount of income from interest payments, royalties, consideration for technical services, and rental payments. The Bulgarian Withholding Tax is imposed at a rate of 15%. BCITA Art. 47. The BCITA does not contain any provisions conditioning the liability for any of the taxes imposed by it on the availability of a credit for such tax against income tax liability of another country. Article 5 of the BCITA provides that tax subjects under the BCITA include local and foreign persons. Tax subjects are the “bearers of the tax liability.” BCITA Art. 5(2).

Section 901 of the Code allows a foreign tax credit for “the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country.” Section 903 of the Code provides that the term “income, war profits, and excess profits taxes” includes a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by a foreign country. A foreign levy is a tax in lieu of an income tax if and only if it is a tax within the meaning of § 1.901-2(a)(2) of the regulations and it meets the substitution requirement set forth in § 1.903-1(b) of the

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regulations. Treas. Reg. § 1.903-1(a).

Section 1.901-2(f)(1) of the regulations provides that only the person by whom the tax is considered paid for purposes of sections 901 and 903 of the Code is the person on whom foreign law imposes legal liability for such tax, even if another person remits such tax. For purposes of §§ 1.901-2, 1.901-2A and 1.903 of the regulations, the person on whom foreign law imposes such liability is referred to as the “taxpayer.” Treas. Reg. § 1.901-2(f)(1).

Before determining the creditability of a foreign tax under section 901 or 903 of the Code, it must first be established that the levy is separate from others imposed by the foreign taxing authority. For purposes of sections 901 and 903 of the Code, whether a single levy or separate levies are imposed by a foreign country depends upon U.S. principles and not on whether foreign law imposes the levy or levies in a single or separate statutes. Treas. Reg. § 1.901-2(d)(1). Where the base of a levy is different in kind, and not merely in degree, for different classes of persons subject to the levy, the levy is considered to impose separate levies for such classes of persons. Id. The Bulgarian Withholding Tax is imposed on the gross amount of limited, specifically enumerated categories of income. The generally imposed levy under the BCITA is imposed on a base of realized net income. The Bulgarian Withholding Tax and the generally imposed levy under the BCITA are each computed by reference to a separate base. Accordingly, the Bulgarian Withholding Tax and the generally imposed levy under the BCITA are separate levies, for purposes of sections 901 and 903.

A foreign levy qualifies as a tax within the meaning of § 1.901-2(a)(2) of the regulations “if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes.” Principles of U.S. law are used to determine whether a foreign levy requires a compulsory payment pursuant to a foreign country’s authority to levy taxes. Id. A foreign levy is not pursuant to a foreign country’s authority to levy taxes, and thus 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. Id.

Section 1.903-1(b)(1) of the regulations provides that a foreign tax satisfies the substitution requirement if the tax in fact operates as a tax imposed in substitution for, and not in addition to, an income tax or a series of income taxes otherwise generally imposed. A foreign tax satisfies the substitution requirement only to the extent that liability for the foreign tax is not dependent (by its terms or otherwise) on the availability of a credit for the foreign tax against income tax liability to another country. Treas. Reg. § 1.903-1(b)(2).

The Bulgarian Withholding Tax satisfies the substitution requirement of § 1.903-1(b) because it operates as a tax imposed in substitution for, and not in addition to, the otherwise generally imposed Bulgarian tax on realized net income. Further, liability for

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Bulgaria's Withholding Tax on income from royalties and consideration for technical services does not depend on the availability of a credit for foreign tax against the income tax liability to another country. Finally, Taxpayer represents that pursuant to the BCITA, legal liability for the Bulgarian Withholding Tax is imposed on Taxpayer, even though a party other than Taxpayer will be required to remit payment of such tax to the Bulgarian government.

Based solely on the information and representations submitted without opining thereon, and assuming that : (1) Bulgaria has a generally imposed tax on realized net income that qualifies as an income, war profits, or excess profits tax described in section 901 of the Code; (2) Taxpayer is not receiving a specific economic benefit as described in § 1.901-2(a)(2); (3) Taxpayer is not subject to Bulgaria's generally imposed tax on realized net income; and (4) the BCITA is not retroactively materially amended in such a way that would change our analysis, we conclude that the Bulgarian Withholding Tax is a tax in lieu of a tax on income, war profits, or excess profits for purposes of section 903 of the Code. Subsequent amendments to the BCITA applicable to prospective taxable years may change our analysis and conclusion with respect to the Bulgarian Withholding Tax. Finally, this conclusion is based on Taxpayer's representation that Taxpayer is subject to the Bulgarian Withholding Tax and legally liable for that tax.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including the characterization of the payments from Customer to Taxpayer.

A copy of this letter must be attached to any income tax return to which it is relevant.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer, and the second taxpayer representative.

Sincerely,  
Anne O'Connell Devereaux  
Assistant to the Branch Chief  
Branch 3  
Office of the Associate Chief Counsel  
(International)