

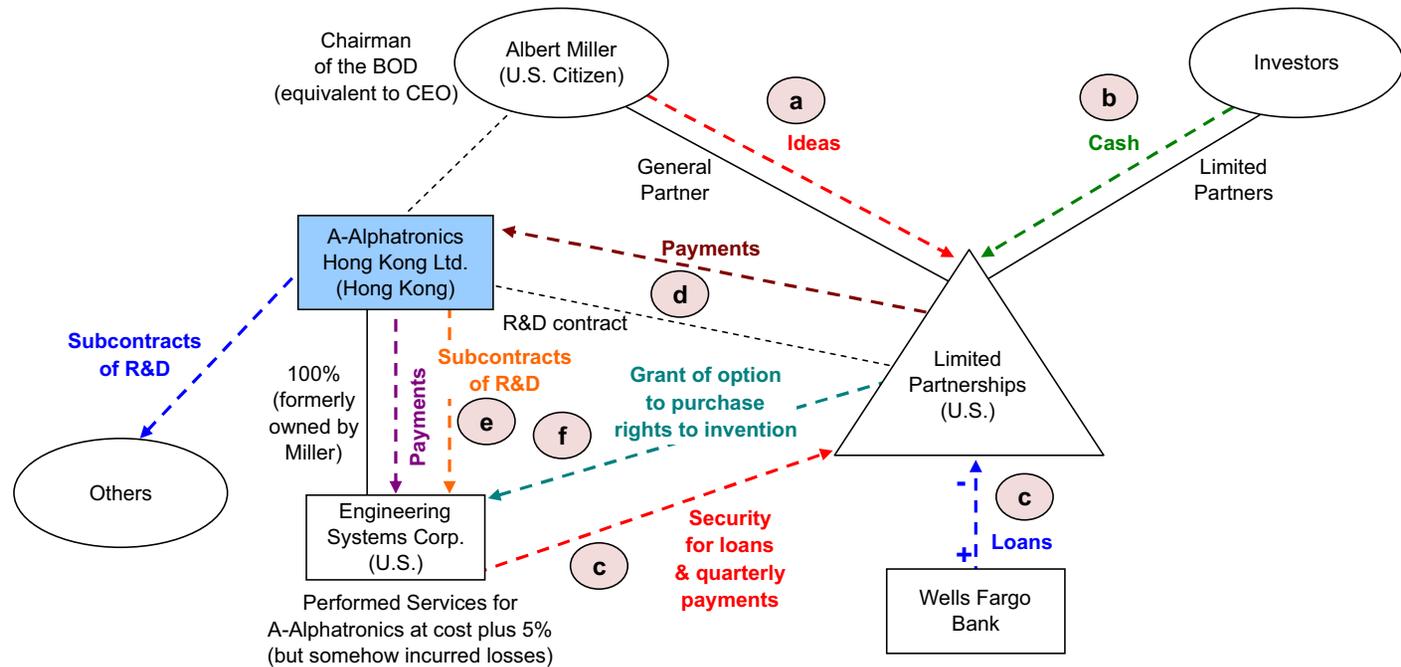
**Miller v. Commissioner
73 TCM 2319 (1997)**

**No Look-Thru for Sourcing of
Back-to-Back Services Payments**

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Beginning in 1972, Miller researched and developed inventions. The inventions were placed into limited partnerships. The partnerships then paid A-Alpha to perform research and development. The Hong Kong corporation then subcontracted all of its research and development contracts, in varying proportions, to wholly owned U.S. and Hong Kong corporations and to independent subcontractors.

Once an idea was selected and assigned to a limited partnership, Miller acting as the general partner of each limited partnership, negotiated a research and development contract with A-Alpha, a Hong Kong limited liability company formed under the



laws of Hong Kong. Capital was raised from investors by selling limited partnership interests, which represented 50 percent of the limited partnerships. The interests sold varied in amount but were typically between \$10,000 and \$20,000. Additionally, each investor agreed to become personally liable for 125 percent of the investor's cash investment. Once the capital was raised, the limited partnerships obtained loans from Wells Fargo Bank. The total amount of capital raised ranged from \$400,000 to \$800,000. This amount was then paid (less attorney's fees and other expenses) to A-Alpha.

Miller was the chairman of the board of directors of A-Alpha, but at no time owned any stock of A-Alpha. The shareholders of A-Alpha were outside investors whose interests were held by nominees, and whose identities were allegedly unknown to Miller. A-Alpha was a holding company which owned both U.S. and Hong Kong corporations.

The IRS asserted that the limited partnerships' payments to A-Alpha for research and development are subject to the 30-percent withholding tax under section 881(a), and that Miller, as general partner of the limited partnerships, was a withholding agent for purposes of section 1442, and personally liable under section 1461. The court concluded that the payments by the limited partnerships are not subject to the 30-percent withholding tax of section 881(a). The fact that a lower tier corporation performs some services in the United States is insufficient to support a conclusion that its higher tier parent corporation also performs services in the United States. The two corporations are and should be treated as separate persons unless one corporate form is a sham. Although it is true that Engineering Systems Corp. was a wholly owned subsidiary of A-Alpha engaged in a U.S. trade or business, it was doing business under its own name as a separate and distinct entity. The services performed by Engineering Systems Corp. did not give rise to U.S. source business income of A-Alpha. In order for A-Alpha to be considered as having U.S. source income by virtue of the performance of services, A-Alpha itself would have to perform the services through agents or employees of its own.