

Canadian private foundation; investment income. A Canadian private foundation, exempt from the Canadian income tax and exempt from U.S. income tax under section 501(c)(3) of the Code, is also exempt from the tax imposed on gross investment income by section 4948(a) by virtue of Article X of the U.S.--Canada income Tax Convention.

Advice has been requested whether a private foundation that is a resident of Canada and exempt from Canadian income tax under Canadian law and from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 is subject to the tax imposed by section 4948(a).

Article X of the Income Tax Convention between the United States and Canada provides that income derived from sources within one of the contracting States by a religious, scientific, literary, educational, or charitable organization of the other contracting State shall be exempt from taxation in the State from which the income is derived if, within the meaning of the laws of both contracting States, such organization would have been exempt from income tax.

Section 4940(a) of the Code imposes on each private foundation which is exempt from taxation under section 501(a) for the taxable year, with respect to the carrying on of its activities, a tax equal to 4 percent of the net investment income of such foundation for the taxable year.

Section 4948(a) of the Code provides that in lieu of the tax imposed by section 4940 there is imposed for each taxable year on the gross investment income (within the meaning of section 4940(c)(2)) derived from sources within the United States (within the meaning of section 861) by every foreign organization which is a private foundation for the taxable year a tax equal to 4 percent of such income.

Section 53.4948-1(a)(3) of the Foundation Excise Tax Regulations provides that whenever there exists a tax treaty between the United States and a foreign country, and a foreign private foundation subject to section 4948(a) of the Code is a resident of such country or is otherwise entitled to the benefits of such treaty (whether or not such benefits are available to all residents), if the treaty provides that any item or items (or all items with respect to an organization exempt from income taxation) of gross investment income (within the meaning of section 4940(c)(2)) shall be exempt from income tax, such item or items shall not be taken into account by such foundation in computing the tax to be imposed under section 4948(a) for any taxable year for which the treaty is effective.

The application of the treaty results in the exemption from income tax of all items of gross income. Therefore, a private

foundation, under the circumstances described, is not subject to the tax imposed by section 4948(a) of the Code.