London Displays Co. N.V. v. Commissioner, 46 T.C. 519 (1966)

The definition of 'commercial equipment' in a tax treaty is determined by the use and purpose of the property, not its artistic nature, when considering tax exemptions.

Summary

London Displays Co. N.V., a Dutch corporation, received income from Madame Tussaud's Wax Museums, Inc. for the use of wax figures in a museum. The IRS argued this income was subject to a 30% U.S. tax. London Displays contended that under the U.S.-Netherlands Tax Treaty, this income was exempt as it was derived from 'commercial equipment.' The Tax Court held that the wax figures, used for income generation, constituted 'commercial equipment' regardless of their potential artistic value, and thus the income was exempt from U.S. tax under the treaty. The court emphasized the commercial use of the assets over their artistic qualities.

Facts

London Displays Co. N.V. (Petitioner), a Netherlands Antilles corporation, was formed to own wax figures. Petitioner acquired wax figures and leased them to Madame Tussaud's Wax Museums, Inc. (Tussaud's), a California corporation, for display in a wax museum. The agreement stipulated that Petitioner would receive 48% of the museum's gross receipts in exchange for providing the wax figures and settings. Tussaud's operated the museum and paid operating costs. The agreement was carried out, though not formally executed, and later terminated. Petitioner did not file a U.S. income tax return, and no withholding tax was paid on the income received from Tussaud's.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Petitioner's federal income tax, asserting the income from Tussaud's was subject to a 30% tax under section 881(a) of the Internal Revenue Code. The Commissioner initially claimed Petitioner was a personal holding company, but conceded this point before trial. The remaining issue was whether the income was exempt under the U.S.-Netherlands Tax Treaty. The Tax Court heard the case to determine the tax deficiency and any penalties for failure to file a return.

Issue(s)

1. Whether income received by Petitioner, a foreign corporation, from a U.S. corporation for the use of wax figures is subject to the 30% tax under section 881(a) of the Internal Revenue Code.

2. Whether such income is exempt from federal taxation under the Income Tax Convention between the United States and the Kingdom of the Netherlands as

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income derived from ‘commercial equipment’.

3. Whether Petitioner is liable for an addition to tax under section 6651(a) for failure to file a U.S. income tax return.

Holding

1. No, the income is not subject to the 30% tax if it is exempt under the U.S.-Netherlands Tax Treaty.

2. Yes, the income is exempt because the wax figures constitute ‘commercial equipment’ within the meaning of the U.S.-Netherlands Tax Treaty.

3. No, because there is no deficiency in income tax, there is no basis for an addition to tax under section 6651(a).

Court’s Reasoning

The court focused on interpreting the term ‘commercial equipment’ within the U.S.-Netherlands Tax Treaty, which exempts royalties for the use of ‘industrial, commercial or scientific equipment.’ The IRS argued that wax figures are ‘works of art’ and not ‘commercial equipment,’ asserting these categories are mutually exclusive. The court rejected this premise, stating, “*we do not believe that works of art and commercial equipment necessarily are mutually exclusive concepts.*“

The court reasoned that the key factor is the *use* of the property. “*The more meaningful consideration in determining whether or not a particular object constitutes commercial equipment is the use to which that object is put and the purpose which it fulfills rather than the aesthetic responses which it arouses.*” In this case, the wax figures were used by both Petitioner and Tussaud’s for commercial purposes – to generate income. The court concluded, “*Regardless of whether or not the figures themselves might be considered by some persons as works of art, they were used herein strictly for their income-producing capacities, and we therefore hold that they constitute commercial equipment within the intendment of the United States-Netherlands tax convention.*“

The court distinguished other tax treaties that specifically mention ‘artistic works,’ noting that the U.S.-Netherlands treaty does not contain such limiting language. It found no basis in the treaty to conclude that a ‘work of art’ cannot be considered ‘commercial equipment’ if used commercially. Since the income was exempt under the treaty, there was no tax deficiency, and consequently, no penalty for failure to file a return.

Practical Implications

This case provides a practical interpretation of ‘commercial equipment’ in tax treaties, emphasizing functional use over inherent nature or artistic value. It

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clarifies that property can simultaneously be considered ‘artistic’ and ‘commercial’ for tax purposes, depending on its application. For legal professionals, this case highlights the importance of analyzing the practical use of assets when interpreting tax treaty provisions related to commercial equipment. It suggests that in similar cases involving tax treaties, the focus should be on the income-generating purpose of the assets rather than their classification under other definitions. Later cases would need to consider the specific language of relevant tax treaties and the factual context of asset usage to determine if property qualifies as ‘commercial equipment’ for tax exemption purposes.

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