Chapter 5
Problems on Tax Jurisdiction

§ 5.01. Review Problems

1. A is a citizen of Brazil. He has a full-time job in that country and generally lives there with his family in a home that he has owned for over 20 years. In year 1, A comes to the United States for the first time. The sole purpose of the trip is business. A intends to stay in the United States for only 180 days, but he runs into problems with his business and is required to stay for 300 days. He comes to the United States again on business in year 2 and stays for 180 days. Early in year 3, he comes to the United States on business and stays for 60 days. Later in the year, he returns to the United States to take his 6-year old son to Disney World in Florida. He stays at Disney World for 10 days and then returns to Brazil with his son.

In year 4, A comes to the United States and remains for 170 days on business. At the end of his business trip, he is joined by his 10-year old daughter, who also wants to see Disney World. They plan to stay in Florida for no more than 10 days. On day 10 of the planned visit, the daughter breaks her leg trying to avoid being crushed by a crowd of people trying to get into Fantasy Land. She is put into the hospital for treatment, where she is required to stay for 10 days. A remains in Florida to be near his daughter. They both leave the United States on the day that the daughter is released from the hospital. Is A a U.S. resident for tax purposes in years 1, 2, 3, or 4?

2. In December of 1989, U.S. President George Bush ordered an airlift of 11,500 American troops to participate in a war against General Manuel Antonio Noriega, the "pineapple-faced narco-dictator of Panama" and his Panama Defense Forces (the facial slur is ***Newsweek's***). Although organized resistance to the American invasion was brief, large numbers of innocent civilians apparently were killed. With defeat unavoidable, Noriega took refuge in the home of the Papal Nuncio. He surrendered to American authorities in early 1990, after being bombarded around-the-clock by military sound trucks playing high-volume rock music. After his capture, Noriega was carted off to the United States and incarcerated. He was brought to trial in late 1991 and found guilty by a jury in April of 1992. As the trial began, ***Newsweek*** (Sept. 23, 1991) carried the following report:

> As Panama's "maximum leader," Gen. Manuel Noriega was briefly America's Public Enemy No. 1. Since the December 1989 invasion that brought him to Florida, his trial — due finally to get underway this week in Miami — has blossomed into a three-ring legal circus. At the center are charges of narcotics smuggling and racketeering that could put him in prison for the rest of his life.

Was General Noriega a U.S. resident for 1990? For 1991? For the rest of his life? Do you see any constitutional objections to taxing him on his world-wide income for 1990 and 1991? Would there be any argument that he was a U.S. resident under pre-1984 law?

3. From the perspective of the taxpayer, what are the advantages of the place-of-management test over the place-of-incorporation test? Which test is more certain of application? What are the likely U.S. tax consequences of a change of residence under the two tests? According to some commentators, the objective of the corporate tax, at least in theory, is to impose current tax on corporate shareholders.

Assuming that objective, should the residence of a corporation turn on the residence of its shareholders? What problems do you see with a residence-of-shareholders test?

4. If you were designing a test for residence of individuals, which of the following factors would you take into account: (1) whether the individual is present in the country for a certain number of days (e.g. 183 days); (2) whether the individual has an abode in the country or in another country; (3) whether the individual is a citizen of the country; (4) whether an individual has established residence in another country; (5) whether an individual has a resident visa.

§ 5.02. Planning Problems on Tax Jurisdiction

Jack & Jill Go Abroad

Jack and Jill (J&J) have been happily married for 30 years. They have two adult children. J&J have a home in Columbus, Ohio. They have lived in that home for many years and plan to retire there in about 10 years. Jack is a geologist. He has received an offer from the On-Shore Drilling Corporation, a Country N corporation, to work for five years in Country N. If he takes the job, he and Jill will rent a home in Country N and live there practically full time. They do expect to return to their Ohio home for about a month each year, and they expect that their children will make occasional visits to Country N. The children will not spend more than two months in Country N in any year. One of them is in graduate school and the other is working full-time as a medical researcher in Chicago. Neither Jack nor Jill would be willing to change their planned living arrangements in any significant way to accommodate a tax avoidance plan. They will, of course, remain U.S. citizens and will retain close ties with friends and family in the United States.

Jill is a retired school teacher and a free-lance writer. She earns about $600 per year from her writing. If Jack takes the job in Country N, she will accompany him, but she does not expect to take a salaried job there. She may continue doing some free-lance writing.

Country N has a tax treaty with the United States based on the U.S./Canada model. Jack's salary has not been set, but it is anticipated that it will exceed $200,000 per year. J&J have substantial investment assets, generating $70,000 per year in income. Included in their portfolio are some State of Ohio tax-exempt bonds, paying annual interest of $40,000. The Ohio bonds are held in Jill's name. The rest of the assets are held jointly. J&J currently do not have any foreign income.

The income tax of Country N has a flat rate of 50 percent, with a phased-out exemption to individuals of $20,000. Country N taxes its residents on a worldwide basis. It has an individual filing system. There are relief provisions for dependent spouses and dependent children, but those relief provisions are phased out for incomes over $100,000. The tax base of the Country N income tax is very broad. It includes all investment income, including income from national, state and local bonds. It has controlled foreign corporation (CFC) rules to prevent tax haven abuses, although the rules have little resemblance to the U.S. anti-avoidance rules contained in subpart F of the Internal Revenue Code. Country N adopted its residency rules using the U.S. rules as its model. In particular, Country N generally treats persons residing in Country N for 183 days or more in a year to be residents.

J&J have received some general tax advice from Bill, an employee of Anderson Touche, an international accounting firm retained by On-Shore. Bill suggests that J&J will be treated as residents of Country N and will be taxable there on their worldwide income, including their investment income. He also told them that the income earned on the Ohio bonds will be taxable by Country N.

Feeling a little uneasy about the tax advice they have been getting, J&J come to you for tax advice. They are worried about being subject to double taxation in Country N and the United States. They are also concerned that they will be paying tax in Country N at a very high rate. You may assume that Bill's statements to them regarding Country N's tax law are correct.

What can you tell J&J? In particular, what are the risks of double taxation and what would you suggest to minimize those risks. What questions, if any, would you like to ask J&J. Why?

Miss S, International Skiing Instructor

Miss S is a professional skiing instructor. She is 28 years old. She is a citizen of Country S and no other country. From December 1 to April 1, she lives in Country S, giving skiing instructions at a famous resort in that country. The resort provides her with free lodgings at the resort and a guaranteed salary of $10,000 for giving group lessons to guests at the hotel. The lodgings have a fair market value of $20,000. With tips and fees from private lessons, Miss S usually earns an additional $50,000 in Country S.

In addition, Miss S owns shares in a Country S mutual fund. From the mutual fund, she receives annual dividends of $20,000, which she reinvests in the fund. Although she owns the mutual fund and is liable for taxes on its income, she holds it jointly with her mother, who lives in Country S. When she is living in Country S, Miss S visits her mother frequently, and the mother occasionally goes to visit her daughter at the ski lodge. The mother was a member of the Country S skiing team in the 1975 Olympics. Aside from her mother, Miss S has no close family. She has an active social life but no steady boy friend.

After the skiing season in Country S ends, Miss S goes to Country B, an island tourist destination, to relax on the beautiful beaches of that country. She stays there from April 1 to August 1. During that time, she lives in a small bungalow that she owns jointly with a girl friend who lives full-time in Country B. The bungalow is located just off one of Country B¡|s nicest beaches. It is valued at $100,000. Miss S is an expert swimmer and does a lot of snorkeling around the coral reefs of the island. On several occasions, Miss S has been offered a job by one of the local resorts to give tourists a guided tour of the coral reefs, but she has always declined the offers. The job would pay $30,000 for the summer season.

At the beginning of August, Miss S travels to Country Z, located in the southern hemisphere. There she stays at a large resort and gives skiing instructions. The resort provides her with free lodgings and meals at the resort and pays her a guaranteed $6.000 to give skiing instructions to guests at the hotel. The meals and lodgings have a fair market value of $10,000. With tips and fees from private lessons, Miss S earns an additional $24,000 in Country Z. Miss S stays in Country Z from August 1 to November 1. She then returns to Country B for the month of November, before returning to Country S at the beginning of December.

Domestic tax rules. Miss S is treated as a resident under the domestic laws of County S, Country B, and Country Z. Country S and Country Z tax their residents on their worldwide income. They give relief from double taxation using the credit method and only through their tax treaties. Both countries tax nonresident individuals only on income having a source in their country. Country B does not tax its residents with respect to their foreign earned income but does tax them on their foreign investment income. Under the tax rules of all three countries, earned income has its source where the services are provided, and dividends have their source in the country where the entity paying the dividends is located. Country Z includes in income the value of food and lodgings provided to employees. Country S and Country B do not tax such food and

lodgings if they are provided on the business premises of the employer. All three countries tax income at a flat rate of 30 percent. They allow no deductions that are relevant to this planning problem.

Tax treaty rules. Country S has a tax treaty with Country Z but does not have a tax treaty with Country B. Country Z has a tax treaty with both countries. All of the treaties are based on the OECD Model Convention.

Questions

(1) In which country is Miss S a resident under the Country S/Country Z tax treaty? Explain. If you believe there is some doubt as to Miss S's country of residence, explain how that doubt would be resolved.

(2) In which country is Miss S a resident under the Country B/Country Z tax treaty? Explain. If you believe there is some doubt as to Miss S's country of residence, explain how that doubt would be resolved.

(3) For purposes of this question only, assume that Miss S is a resident of Country S under the Country S/Country Z treaty and a resident of Country B under the Country B/Country Z treaty. How will Miss S be taxed by each of the three countries? In giving your answer, specify the relief from double taxation that she would be entitled to receive and discuss whether she will be subject to double taxation that is not relieved under the treaties.

(4) For purposes of this question only, assume that Miss S is a resident of Country Z under the Country S/Country Z treaty and a resident of Country Z under the Country B/Country Z treaty. How will Miss S be taxed by each of the three countries? In giving your answer, specify the relief from double taxation that she would be entitled to receive and discuss whether she will be subject to double taxation that is not relieved under the treaties.