Exam No. _________

Wayne State University
Law School

Winter Term, 1995
Prof. Michael J. McIntyre

INTERNATIONAL ASPECTS of U.S. TAXATION

Maximum Time: 3 hours

Maximum Points: 100

Tuesday, May 9, 1995

Instructions

1. Write your **Exam Number** in the space provided in the upper right hand corner of this exam. Also write your exam number, the name of your instructor (McIntyre), and the name of this course (Int'l Tax) on the cover of your Bluebook. Please do this now. If you are typing your exam, you must put your Exam Number on the top right of every page and the name of the instructor and the name of the course on the first page.

2. Thank you for putting your **Exam Number** and other information in the appropriate spaces. (If you have not done so, please stop reading and do so now.) Please do NOT put your own name on your bluebook or on your copy of the exam.

3. This is an **open book** examination. You are expected to have with you a copy of the Code and Regulations, the McIntyre treatise, and the Workbook. You are permitted to have any books, notes or other materials you have used during the course. You may use a pocket calculator.

4. This examination has two parts. Answer the questions in part I in your bluebook, noting the space guidelines. Part II contains ten (10) multiple choice questions. Answer that part on your copy of the exam.

5. In writing in your bluebook, do not use the back side of the pages and please double space (that is, write on every other line). If you are typing, please leave big margins and double space.

Note To Proctor:

All copies of the Examination MUST be returned to you by the end of the examination period. Please check carefully to be sure you can account for all copies. Persons allowed to leave the examination room ***for any reason*** *must leave their copy of the examination with you to hold until they return.*

Assumptions Applicable to this Examination

Unless a question specifies otherwise, make the assumptions set forth below in answering the questions on this examination:

1. Taxpayers are using the cash method of accounting.
2. Taxpayers are using the calendar year as their taxable year.
3. Except for the transactions described in the questions, no transactions relevant to the answers have occurred during the relevant taxable years.
4. Technical terms and words of art are used in their exact tax sense.
5. For persons taxable on their net income under Code sections 1 or 11, the United States employs a flat individual tax rate of 36 percent and a flat corporate tax rate of 35 percent.
6. When a question requires you to consider a tax treaty between the United States and a foreign country, assume that the treaty has terms identical (other than the name of the treaty partner) to those of the U.S./Spain Treaty unless the question states otherwise.
7. All taxpayers have elected to credit rather than deduct foreign income taxes.
8. Any taxpayer identified as a "corporation" qualifies as a corporation for U.S. tax purposes.
9. Taxpayers having base company income or insurance income under subpart F of the Code cannot satisfy the exculpatory provisions of Code sections 954(b)(3) (5 percent de minimus rule) or 954(b)(4) (income subject to high foreign taxes).
10. All stated amounts of taxable income and earnings and profits have been computed according to U.S., rather than foreign, tax concepts. A corporation's earnings and profits equal its taxable income minus its income taxes paid.
11. For purposes of computing the allocation of research and development expenses, assume that one-half of the expenses are allocated to the place where the research is conducted and the other on-half is allocated in accordance with the sales (gross receipts) method.
12. The 1993 tax act (and all previous tax acts) are fully effective and any transitional provisions have lapsed or expired.

I. Essay
(maximum points: 50)

Instructions. Answer the following two questions in your bluebook. Write in ink and do not write in the margins. **Number your answers clearly.** Please write on every other line (double space), and do not write on the back side of the bluebook pages. Observe the maximum space limitations for each question. Your answer to each questions may not exceed three bluebook pages, double spaced, of normal-sized writing. *You will suffer a grade penalty, proportionate to the offense, for exceeding the space limitations.*

Note on Handwriting: A person with normal-sized handwriting typically gets about 10 to 12 words per line. Make an appropriate adjustment if your handwriting is unusually large or small. Please, do not count your words. A double-spaced page of a bluebook has 25 lines.

Note to typists: 1 handwritten line of a bluebook (normal size writing) is equivalent to 1 line of a typed page (8½" x 11") with 1½ inch margins (pica) or 2 inch margins (elite). This notice is typed with a pica font (Courier 12 point) and has 1½ inch margins.

1. (Maximum Points: 25) 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./Spain 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 CFC rules to prevent tax haven abuses, although the rules have little resemblance to the subpart F rules. Under its tax code, Country N treats all persons residing in Country N for 183 days or more in a year to be residents. Indeed, the Country N adopted its residency rules using the U.S. rules as its model.

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. They also want to double check on the advice they have been getting from Bill. You may assume that the statements regarding Country N's tax law are correct.

Question. What can you tell J&J? In particular, please indicate what you consider to be the risks of double taxation and what you would suggest to minimize those risks. Note: If you feel you need more information to address some issues, indicate what questions you would like to ask J&J and explain why the answer would affect your advice.

2. (Maximum Points: 25) X, a U.S. corporation is in the oil business and the electric motor business. It has established a branch operation in France for the manufacture of the electric motors. The electric motors manufactured by that branch are sold in Europe and in the United States. The European sales are made by the French branch, and the U.S. sales are made through a U.S. branch of X.

Gross Income and Gross Receipts. For the current taxable year, X has gross receipts from the electric motor sales of $20,000. The U.S. gross receipts total $10,000 and the European gross receipts total $10,000. X's gross income from the electric motor sales are $6,000 – $3,000 attributable to the United States sales and $3,000 attributable to the European sales. X also had gross receipts and gross income of $4,000 derived from oil extraction in Colorado. The following table summaries the information in this paragraph.

Summary of Gross Income and Gross Receipts						
Divisions of X	**U.S.**		**Europe**		**Total**	
	Gross Receipts	**Gross Income**	**Gross Receipts**	**Gross Income**	**Gross Receipts**	**Gross Income**
Electric Motors	$10,000	$3,000	$10,000	$3,000	$20,000	$6,000
Oil Extraction	$4,000	$4,000	$0	$0	$4,000	$4,000
Totals	$14,000	$7,000	$10,000	$3,000	$24,000	$10,000

Deductions. X has paid $1,000 of interest to a New York bank on unsecured loans during the year, the proceeds of which were used in the oil business. It had general overhead expenses relating to the electric motor business of $2,000. It had $1,500 of general overhead expenses related to the oil extraction business. It has a deduction for research of $1,000. The research was conducted in the United States on improvements in its electrical motors. X has no other expenses for the year.

Summary of Deductions

Interest $1,000
Electric Motor Overhead $2,000
Oil Extraction Overhead $1,500
Electric Motor R&D $500

Total $5,000

The assets of X have a tax book value of $10,000. Their fair market value is unknown. The tax book value of the oil extraction assets is $4,000 and relate exclusively to the production of U.S. source gross income. The remaining assets (tax book value of $6,000) relate to the earning of foreign source gross income and U.S. source income from the electrical motors. An analysis shows that 50 percent of the gross income generated by those assets is U.S. source income and the remaining 50 percent of the gross income generated by those assets is foreign source income.

Question. How much foreign source taxable income does X have for the year?

II. Multiple Choice Questions

(maximum points: 50)

Mark your choice of alternative answers to each question by circling its identifying letter on your copy of the exam. *Do **Not** circle more than one alternative answer*. Your score will be based on the number of correct answers. No points are deducted for incorrect answers. In answering each question, make the assumptions stated on page two (2) of this examination unless a contrary assumption is stated in the question.

If you believe that unstated facts are crucial to your answer, or if you believe that a question is ambiguous, go ahead and answer the question as best you can. Then circle the number of the question on the question sheet and, on the space provided on the last page of this exam, identify the unstated facts or the ambiguities and explain their relevance to the question. If your grounds for challenging a question are well-founded and if you have properly shown the relevance of an alleged omission of fact or ambiguity to the answer, you will receive full credit for your answer. There are no intentional ambiguities or omissions of necessary facts.

> ***Warning****: If you decide to explain your answer, you do so at your own risk. You will receive* ***no credit*** *for circling what I have judged to be the correct answer to a question if you have challenged that question and your grounds for doing so are unfounded or incorrectly stated.*

[Multiple Choice Questions not made public.]

--- Space to Explain Multiple Choice Answers ---
Use ONLY if necessary

Question (   ) ____________________

Question (   ) ____________________

Question (   ) ____________________