Int'l Tax
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Notes on the Answers

Question 1. *U.S. Steel* (1980) was decided with respect to tax years 1957-1961, before the adoption of subpart F rules in 1962. Under current law, Navios would be a CFC, and its income would be subpart F shipping income, taxable currently to its U.S. shareholder, U.S. Steel. Note also that the 1994 regulations have provision that seems to address the *U.S. Steel* situation. See, e.g., Reg. § 1.482-1(d)(3)(ii)(C)(Ex. 1 & 2) (dealing with volume discounts).

Question 2. *CCA, Inc*. was decided before the adoption of the vote or value rule. At the time, only voting control was relevant in determining whether a foreign corporation was a CFC. It is not completely clear under the facts of the case, but it is highly likely that the U.S. shareholders own stock with a value greater than 50 percent of the value of all outstanding shares.

Question 3. The plan is no good. First, HCo is a CFC, and its income is base company sales income because there is a sale to a related person. So all of the income of HCo would be taxable currently to Flowers, Inc. under subpart F. Second, the sales from CCo to Flowers, Inc. using the cost-plus method will not comply with the regulations under section 482. CCo will be making arm's length sales to unrelated persons in Ohio and Wisconsin, and those sales will set the price for the comparable sales to Flowers, Inc. Third, the borrowing by Flowers, Inc. to finance the operations of CCo will give Flowers, Inc. the interest deduction, whereas if CCo made the loan itself, it would get the deduction. It is better tax planning to have CCo make the loan because tax rates are higher in Canada. In addition, by making a capital contribution to CCo, Flowers, Inc. will increase its basis in the CCo stock, which will result in more interest being allocated to foreign source income, thereby reducing the limitation on the credit, which would reduce the amount of the Canadian tax that would be creditable by Flowers, Inc.

To avoid subpart F, HCo should make the sales directly to the mail order customers. Flowers, Inc. could serve as HCo's commission agent in making the sales without creating a subpart F problem. The risk of that approach, however, is that the fixed place of business of Flowers, Inc., or the place of business of Flowers, may be treated as the fixed place of business of HCo, resulting in HCo being taxable under IRC § 882 on its effectively-connected income. If HCo is treated as having a U.S. office, the income derived through that office would be U.S. source income taxable as ECI. Avoiding the office rule will be difficult unless the taxpayer is willing to conduct some real economic activity in the Antilles.