

**INTERNATIONAL ASPECTS OF U.S. TAXATION**

LEX 7401

MAXIMUM TIME: 3 HOURS

MAXIMUM POINTS: 100

TUESDAY, MAY 9, 2006, AT 1:30 P.M.

**Instructions**

1. Write your **Exam Number** in the space provided in the upper right hand corner of this page and also on page 7 (Multiple Choice). 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 also 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 or other identifying information (e.g., LL.M. student, graduating senior) 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 selected sections of the Code and Regulations and the course materials distributed in class or posted on the class website. 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 three parts. Answer the four (4) questions in Part I in your bluebook, noting the space guidelines. Part II contains fifteen (15) multiple choice questions, and Part III contains fifteen (15) True/False questions. Answer both of those parts *on your copy of the exam* by circling the appropriate choices.
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 (1½ inches each side) 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. Individual taxpayers are using the cash method of accounting, and corporate taxpayers are using the accrual 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 35 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, etc., of the treaty partner) to those of the U.S./Canada Income Tax 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 minimis* 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. The various tax acts through 2005 are fully effective and any transitional provisions have lapsed or expired.
12. The taxpayer has no carrybacks or carryforwards of the foreign tax credit.

## I. Essay

(maximum points: 40)

(Maximum Length: 4 bluebook pages, double spaced)

*Instructions.* Answer the following 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. *You will suffer a grade penalty, proportionate to the offense, for exceeding the space limitations.* No penalty is imposed for exceeding the space limits by 3 lines or less.

*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.

Note to typists: 1 handwritten line of a bluebook (normal-sized writing) is equivalent to 1 line of a typed page (8½" × 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.

### A.

(Maximum points: 15)

(Maximum Length: 2 bluebook pages, double spaced)

CanadaBoat, Inc. (CB) is a corporation organized in Canada and owned by a group of Canadian residents. It operates a small fishing fleet on Lake Huron. Lake Huron is one of the Great Lakes and is located partly within Canada and partly within the United States. CB takes tourists for fishing expeditions for a fee of \$400 per day. The typical outing begins in Canada, where the tourists board one of the fishing boats. The actual fishing takes place primarily in U.S. waters because the fishing is thought to be better there than in Canadian waters. The fishing boats occasionally dock at U.S. ports to take on fuel and supplies and the occasional tourist.

For the current year, CB has earned profits from its operations of \$200,000. Under a special tax incentive for small Canadian businesses, CB is taxable in Canada at a rate of only 10 percent. Canada treats all of the income of CB as derived from Canada and imposes a tax of \$20,000 on that income.

**Question 1** (10 points). Is CB taxable in the United States on some or all of its income, leaving aside any possible defenses under the U.S.-Canada tax treaty? Discuss.

**Question 2** (5 points). What protection, if any, would CB have to U.S. taxation under the U.S.-Canada tax treaty? Discuss.

**B.**

(Maximum points: 15)

(Maximum Length: 1 bluebook page, double spaced)

Chin Choy (CC) is a manufacturer of kites in China. He sells unfinished kites to Bob Smith, the proprietor of a small kite shop on Cape Cod, Massachusetts, at a unit price of \$2 (including shipping). The unfinished kites are manufactured in accordance with detailed instructions from Bob. They are shipped by CC from a warehouse in Hong Kong by public carrier, generally by UPS. Title to the kites passes to Bob at the time of shipment.

Bob finishes the kites, affixes his brand name, “Ye Old Kite Shoppe,” to the kites, and sells them to tourists. His unit costs are \$5, including the \$2 paid to CC. Bob is now planning to export the kites into the United Kingdom, where he understands there is a good market for traditional cloth kites of the type he sells. His plan is to establish a wholly-owned corporation in Canada, to be called UKites. He will sell the kites to UKites for cost (\$5) plus 20 percent (\$1). He has located a dozen manufacturers of similar products who sell to distributors for cost plus 20%. The Canadian company would be managed from Bob’s Cape Cod office and would be treated under UK law as a resident of the UK.

The sales to UK customers would be done over the Internet. Bob plans to have UKites set up a web site that would allow UK customers to select the kites they want from the web site and purchase them on-line, using VISA or Mastercard. The sales price would be \$20 per kite. UKites would contract with iWeb, an independent U.S. web site hosting company to design and host the web site. iWeb hosts over 200,000 web sites for unrelated clients. The typical hosting cost to Bob would be \$50 a month, including provision for a computer “shopping cart” that would allow shoppers to select items and make credit-card purchases on-line. Bob expects that UKites will make sales of around 10,000 kites per year in the United Kingdom, for gross receipts of \$200,000. The total profits are expected to be \$130,000.

**Question 3** (15 points).

Will Bob or UKites be taxable by the United States on any part of the income derived from the sale of kites in the UK? Discuss.

**C.**

(Maximum points: 10)

(Maximum Length: 1 bluebook page, double spaced)

On May 2, 2006, the Advocate General of the European Court of Justice issued an advisory opinion in *Cadbury Schweppes Overseas Ltd. v. Commissioners of Inland Revenue* (United Kingdom), Case C-196/04. Here is the conclusion of that opinion:

Articles 43 EC [Freedom of Establishment] and 48 EC [extending Article 43] do not preclude national tax legislation which provides for inclusion in the tax base of a resident parent company profits of a controlled foreign company (CFC) established in another Member State where those profits are subject in that State to a much lower level of taxation than that in effect in the State of residence of the parent company, *if that legislation applies only to wholly artificial arrangements intended to circumvent national law*. Such legislation must therefore enable the taxpayer to be exempted by providing proof that the controlled subsidiary is genuinely established in the State of establishment and that the transactions which have resulted in a reduction in the taxation of the parent company reflect services which were actually carried out in that State and were not devoid of economic purpose with regard to that company's activities.

(Emphasis added.)

**Question 4** (10 points).

How would the CFC rules of the United States be affected if they were subject to the limitations that would be imposed on the United Kingdom (and other EU countries) under the ECJ's Advocate General quoted from above? Discuss the implications of those limitations in light of the purposes of subpart F and the CFC rules of the United States.

## II. Multiple Choice Questions (maximum points: 45 — 3 points each)

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 per question. 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, in 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.*

[MC Questions Omitted]

## III. True/False Questions (maximum points: 15)

Mark your choice of alternative answers to each question by circling its identifying letter **on your copy of the exam**. Ambiguous questions may be challenged according to the rules set forth in Part II. Again, there are no intentional ambiguities.

[T/F Questions Omitted]