Exam No. _________

Wayne State University
Law School

Winter Term, 2007
Prof. Michael J. McIntyre

International Aspects of U.S. Taxation

Lex 7401

Maximum Time: 3 hours
Maximum Points: 100
Wednesday, May 2, at 1:30 p.m.

Instructions

1. Write your **Exam Number** in the space provided in the upper right hand corner of this page (unless the number is already there). 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 three (3) 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 2006 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.

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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.
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A. Nuts and Bolts)

(Maximum points: 25)

PCo is a U.S. corporation. It owns all of the stock of ACo and BCo, both U.S. corporations. ACo owns all of the stock of FCo, a corporation organized in France. FCo owns 60% of the stock of GCo, a German corporation. The remaining 40% of the stock of GCo is traded on the German stock exchange. BCo owns all of the stock of HCo, a company organized in the Cayman Islands. The Cayman Islands does not have an income tax.

During the year, GCo earns profits of $2,000 from the operation of a brokerage house in Berlin, Germany. It pays a German income tax of $800 (40% rate). It distributes $600 (one half of its earnings and profits) to its shareholders, with FCo receiving $360. FCo pays an income tax of $36 (10 percent rate) to the French government on the dividend.

FCo also earns profits of $1,000 in France from the purchase and sale of cheese from an unrelated factory located in that country. The cheese is sold to customers located in the United States. The sales are made by HCo, acting as an agent for FCo. FCo pays no taxes to France on the income derived from the sale of the cheese. HCo has an office in the United States through which the sales of cheese are made. HCo receives a commission of $500 from the sale of cheese. The amount of the commission can be justified under the transfer-pricing rules of the United States. FCo distributes to ACo its net after-tax profits of $1,324.

Question 1 (10 points, maximum length: 1 bluebook page, double spaced).

Is FCo taxable in the United States? Discuss both the tax treatment under the Code and under the U.S./France tax treaty. You may assume that this treaty follows the OECD Model Convention and has no special features.

Question 2 (15 points, maximum length: 1 bluebook page, double spaced).

How is ACo taxed on the dividend of $1,324 received from FCo? Compute ACo's taxable income and the allowable foreign tax credit that ACo can claim for the foreign income taxes it paid directly or indirectly to a foreign government. Also compute the limitation on the credit. Show your work and explain how you reached your result. Ignore the possible application of any tax treaty.

B. (Tax Policy)

(Maximum points: 15)
(Maximum Length: 2 bluebook pages, double spaced)

Senators Byron Dorgan (D-ND) and Carl Levin (D-MI) recently introduced a bill to deal with tax haven abuses. In brief, the bill would treat a CFC as a domestic corporation if it is organized in a listed tax-haven country. The text of the bill is set forth in the box below.

> Section 7875.
> CONTROLLED FOREIGN CORPORATIONS IN TAX HAVENS TREATED AS DOMESTIC CORPORATIONS
>
> (a) GENERAL RULE.—If a controlled foreign corporation is a tax-haven CFC, then, notwithstanding section 7701(a)(4), such corporation shall be treated for purposes of this title as a domestic corporation.
>
> (b) TAX-HAVEN CFC.—For purposes of this section—
>
> (1) IN GENERAL.—The term 'tax-haven CFC' means, with respect to any taxable year, a foreign corporation which—
>
> (A) was created or organized under the laws of a tax-haven country, and
>
> (B) is a controlled foreign corporation (determined without regard to this section)
>
> for an uninterrupted period of 30 days or more during the taxable year.
>
> (2) EXCEPTION.—The term 'tax-haven CFC' does not include a foreign corporation for any taxable year if substantially all of its income for the taxable year is derived from the active conduct of trades or businesses within the country under the laws of which the corporation was created or organized.
>
> (c) TAX-HAVEN COUNTRY.—For purposes of this section—
>
> (1) IN GENERAL.—The term 'tax-haven country' means any of the following:
>
> [list of 39 tax-haven countries omitted]

The purpose of the bill, according to the press release issued by the senators is to "combat offshore tax-haven abuses and ensure that U.S. multinational companies pay the U.S. taxes that they rightfully owe." They go on to state:

> The *New York Times* got it right when it suggested that "instead of moving headquarters offshore, many companies are simply placing patents on drugs, ownership of corporate logos, techniques for manufacturing processes and other intangible assets in tax havens. The companies then charge their subsidiaries in higher-tax locales, including the U.S., for the use of these intellectual properties. This allows the companies to take profits in these havens and pay far less in taxes."

Question 3 (15 points).

Evaluate the Dorgan-Levin proposal. In particular, discuss whether the proposal, if adopted and administered effectively, would achieve a fair result and whether it would have negative or positive consequences for the U.S. economy. Also discuss whether you believe it would be likely to achieve its objective of combating offshore tax-haven abuses. What changes, if any, would you make to the proposal to better achieve its professed goal?

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.*

[Multiple choice Questions Omitted]

III. True/False Questions
(maximum points: 15 — 1 point each)

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.

[True/False Questions Omitted]

--- Space to Explain Multiple Choice and True/False Answers ---
Use ONLY if necessary

Question (   )

Question (   )

Question (   )