

International Aspects of U.S. Taxation
LEX 7401
Final Exam
Notes on the Answers

1. The tax is creditable. An excess profits tax that operates as an income tax is creditable. See *Exxon Corp.* case. The issue in *Exxon* was whether there was a “specific economic benefit” within the meaning of Reg. § 1.901-(2)(a)(2)(ii)(b). Here the Swedish government does not own the manganese nodules, so the levy is not a payment for those nodules. It is clearly a tax.

2. Baskets: (1) Shipping, (2) Passive, and (3) General.

3. PCo has the following types of subpart F income:

1. Shipping income of \$90,000 earned by HCo.

2. Shipping income (income from high seas) of \$150,000 earned by SCo. (See IRC § 954(f) (flush language).

3. Interest income of \$10,000 earned by HCo.

4. Gross up is \$165,000 (\$90,000 deemed paid taxes in General Basket and \$75,000 taxes on manganese nodules income in the Shipping Basket).

5. The amount in each of the three baskets is:

1. Shipping Basket = \$240,000 (\$90,000 shipping income from transporting goods and \$150,000 from sale of manganese nodules). Note that these amounts are taxable as deemed dividends under Subpart F, although the profits from the manganese nodule sales are actually distributed.

2. Passive Basket = \$10,000 interest . Note that there is no exception in the Passive Basket for interest incomes earned as part of the taxpayer’s business.

3. General Basket = \$400,000. Note that the gross-up amounts go into the baskets that contains the income to which the grossed-up taxes relate.

6. Calculation of Allowable Credit after Limitation.

1. Shipping Basket. The Limitation is $\$240,000 \times 35\% = \$84,000$. The taxes associated with that basket are \$75,000, so that amount is creditable against the deemed dividend income.

2. Passive Basket. No taxes were paid on the interest income, so no credit is allowable.

3. General Basket. The limitation is $\$300,000 \times 35\% = \$105,000$. The taxes paid with respect to the General Basket are \$90,000, so that amount is creditable.

7. Checking the box to make HCo has no effect under the facts of this case. HCo will now be treated, for U.S. tax purposes as a branch of SCo. SCo is a CFC, so the income of HCo will now be treated as the income of SCo and will be taxable as a deemed dividend to PCo. The two categories of income, passive income and shipping income, do not require a transaction with a related person to be subpart F income, so the possible benefits of check the box would not apply.

8. Essay on relative benefits of ECI rule and PE rule.

1. PE rule may be easier to apply in many cases. But it permits tax avoidance by selling into a country and avoiding having an office. Also various “preliminary” and “auxiliary” activities are free of tax. A taxpayer can avoid or minimize taxes by having more several places of business, none of which are treated as fixed. The biggest weakness of the PE rule is that it prevents the source country from taxing income derived in that country from substantial economic activity in that country.

2. The ECI rule is less definite, but in some respects, that indefiniteness is a plus because it makes the rule more difficult to plan around. The ECI includes a force-of-attraction rule. Under the PE rule, a foreign taxpayer can have an office that constitutes a PE and then sell stuff directly to U.S. customers that is similar to what is sold by the PE and avoid tax because those sales are not attributable to the PE. The force-of-attraction rule prevents that avoidance.

3. I prefer the ECI concept, for the reasons expressed in item 2, above. The point of the question was for the test taker to take apposition (either one) and present the arguments that might support that position. Note: I actually prefer a system that would modify the ECI concept in some respects.