

Practical Guide to
U.S. Taxation of
International Transactions

7th Edition

STUDY PROBLEMS

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Preface

The authors of the Seventh Edition of the *Practical Guide to U.S. Taxation of International Transactions* have prepared this Study Problems booklet as a companion to the text to help students as they work through and master the materials presented. It is anticipated that many instructors will supplement the materials offered in this concise booklet with their own exercises and assignments.

U.S. taxation of international transactions is a developing area. The authors encourage students to keep a close watch on new law developments by accessing research services such as those offered on CCH® IntelliConnect™ or other professional sites through their school libraries. Alternatively, CCH's tax home page at <http://tax.cchgroup.com> posts tax briefings that are freely available to the public on substantial new tax law developments.

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Chapter 1

PROBLEM 1

When a U.S. person is in an excess credit position, the noncreditable foreign income taxes increase the total tax burden on foreign-source income beyond what it would have been if only the United States had taxed that income.

Identify two strategies for reducing excess credits.

PROBLEM 2

U.S. tax law contains a two-pronged system for taxing the U.S.-source income of foreign persons.

Briefly explain this system.

Chapter 2

PROBLEM 1

Harry is a citizen and resident of Saudi Arabia (the United States does not have an income tax treaty with Saudi Arabia). During the current year, Harry never visits the United States nor does he hold a green card. However, he received a dividend from Micro Corporation, received interest on a bond issued by MBI Corporation, realized a gain on the sale of Extel Corporation stock, and realized a gain on the sale of 1,000 acres of undeveloped land located in Texas. Micro, MBI and Extel are all corporations organized in the United States.

Describe the U.S. tax consequences of each of the above items of income. Also, indicate how your answers would change if Harry held a green card.

PROBLEM 2

Assume you are on the staff of a U.S. Senator from your home state. The Senator is interested in reforming the U.S. tax system, and has asked you for your opinion of the current system for taxing the foreign operations of U.S. companies, as well as potential alternative systems for taxing such income. The Senator is particularly interested in the relative effects of these different systems on U.S. tax revenues and the competitiveness of U.S. companies in foreign markets.

Prepare a one to two-page memorandum that you could use to brief the Senator on these issues.

PROBLEM 3

In *Cook v. Tait*, 265 US 47 (1924), what was the taxpayer's argument for why he should not be subject to U.S. federal income tax? Why did the Supreme Court reject his argument?

PROBLEM 4

USACO is a domestic corporation that manufactures products in the U.S. for distribution in the U.S. and abroad. During the current year, USACO derives a pre-tax profit of \$10 million, which includes \$1 million of foreign-source income derived from a country X sales office that is considered an unincorporated branch for U.S. tax purposes. The country X corporate income tax rate is 50% and the U.S. tax rate is 35%.

- a. What would be the worldwide effective tax rate on the \$1 million of foreign profits, assuming the U.S. taxes the worldwide income of domestic corporations, but allows an unlimited credit for foreign income taxes?
- b. What would be the worldwide effective tax rate on the \$1 million of foreign profits, assuming the U.S. allows a credit for foreign income taxes, but the credit is limited to the U.S. tax attributable to foreign-source income?
- c. What would your answer to part (b) change if the foreign tax rate was 30% rather than 50%?

Chapter 3

PROBLEM 1

Engco, a domestic corporation, produces industrial engines at its U.S. plant for sale in the United States and Canada. Engco also has a plant in Canada that performs the final stages of production with respect to the engines sold in Canada. All of the output of the Canadian plant is sold in Canada, whereas only one-third of the output of the U.S. plant is shipped to Canada. The Canadian operation is classified as a branch for U.S. tax purposes. During the current year, Engco's total sales to Canadian customers were \$10 million, and the related cost of goods sold is \$7 million. The average value of property, plant and equipment is \$30 million at the U.S. plant, and \$5 million at the Canadian plant. Engco sells all goods with title passing at the Canadian plant in the case of Canadian sales and at the U.S. plant in the case of U.S. sales.

- a. How much of Engco's export gross profit of \$3 million is classified as foreign-source for U.S. tax purposes?
- b. Now assume that the facts are the same as in part (a), except that the Canadian factory is structured as a wholly-owned Canadian subsidiary, rather than a branch. Engco's sales of semi-finished engines to the Canadian subsidiary (which still represent one-third of its output) were \$6 million during the year and the related cost of goods sold was \$4 million. The Canadian subsidiary's total sales of finished engines to Canadian customers (which represents all of its output) was \$10 million and the related cost of goods sold is \$7 million. The average value of property, plant and equipment is still \$30 million at the U.S. plant, and \$5 million at the Canadian plant, and Engco sells all goods with title passing at its U.S. plant. How much of Engco's export gross profit of \$2 million is classified as foreign-source for U.S. tax purposes?
- c. How would your answer to part (b) change if Engco sold its goods with title passing at the customer's location?

PROBLEM 2

Pursco is a domestic corporation that distributes scientific equipment worldwide. During the current year, Pursco had \$100 million of sales, a gross profit of \$40 million, and incurred \$30 million of selling, general and administrative expenses (SG&A), for taxable income of \$10 million. Pursco's sales include \$20 million of sales to foreign customers. The gross profit on these foreign sales was \$10 million. Pursco transferred title abroad on all foreign sales, and therefore the entire \$10 million is classified as foreign-source income. A time management survey was recently completed, and indicates that employees devote 90% of their time to the company's domestic operations and 10% to foreign operations. Compensation expenses account for \$20 million of the \$30 million of total SG&A expenses. Assume Pursco's \$10 million of taxable income is subject to U.S. tax at a 35% rate.

Compute Pursco's foreign tax credit limitation under the following independent assumptions.

- a. Pursco determines the amount of SG&A expenses allocable to foreign-source income using gross sales as an apportionment base.
- b. Pursco determines the amount of SG&A expenses allocable to foreign-source income using gross profit as an apportionment base.
- c. Pursco determines the amount of SG&A expenses allocable to foreign-source income using time as an apportionment base for the compensation component of SG&A, and gross sales as an apportionment base for the all other SG&A expenses.

PROBLEM 3

In *Peter Stenkowski v. Comm'r*, 690 F2d 40 (1982), why was the taxpayer arguing that the salary he received for playing hockey for the New York Rangers covered not only the regular hockey season and playoffs, but also the off-season and training camp?

PROBLEM 4

Treas. Reg. §1.861-18 provides rules for classifying transactions relating to software. These rules generally classify transactions involving mass-market software as a transfer of a copy of computer program (a "copyrighted article") rather than a transfer of the copyright itself (a "copyright right"). For sourcing purposes, the former is considered an item of inventory, whereas the latter is considered an intangible asset. A transfer of a copyrighted article is treated as a sale if the underlying license is stated to be perpetual and a lease if the use of the copyrighted article is limited in term, e.g., one week. Assume that the mass-market software in question was developed by the U.S. software company (its engineers and programmers are located in Seattle), and reproduced (i.e., copied onto CDs and boxed for distribution) in the United States.

Describe how much foreign-source income would be generated by the transfer of a copy of this software to a Japanese customer for use in Japan under each of the following independent assumptions.

- a. The underlying license is stated to be perpetual.
- b. The use of the copyrighted article is limited in term.
- c. How would your answer to part (a) change if instead of reproducing the software in the United States, the U.S. software company establishes a Japanese subsidiary and licenses that copyright right to that subsidiary, whereby the subsidiary can reproduce and distribute the software to Japanese customers.

Chapter 4

PROBLEM 1

Chipco, a domestic corporation, produces the world's best tasting chocolate chip cookies. In addition to its domestic sales, Chipco markets its cookies abroad through an extensive network of branch sales offices. Chipco's operating results for the current year are summarized below, by source and type of income:

U.S.-source manufacturing profits	\$60 million
Foreign-source manufacturing profits	\$40 million
Foreign-source passive investment income	<u>\$10 million</u>
U.S. taxable income	<u>\$110 million</u>

Chipco paid \$15 million of foreign taxes on its foreign-source manufacturing profits and \$2 million of foreign taxes on its foreign-source passive investment income. Assume that the U.S. tax rate is 35%.

Compute Chipco's total foreign tax credit, as well as the amount of excess credits (or excess limitation) in each separate basket of income.

PROBLEM 2

Quantco, a domestic corporation, is an engineering consulting firm that has its main offices in San Diego, California. Because Quantco does a considerable amount of business in China, it has a branch office in Beijing. During the current year, Quantco generates a total pre-tax profit of \$100 million (all from active business operations), including \$80 million of profits from its U.S. operations and \$20 million of profits from its Chinese operations. Assume the U.S. tax rate is 35% and the Chinese rate is 40%.

Compute Quantco's creditable foreign income taxes, foreign tax credit limitation, and excess credits (if any).

Now assume that Quantco has a second foreign branch office in Singapore which generated \$10 million of profits (all from active business operations), on which Quantco pays Singapore taxes at a rate of 25%. Recompute Quantco's creditable foreign income taxes, foreign tax credit limitation, and excess credits. What is the name of the phenomenon by which the Singapore profits resulted in the elimination of the excess credits on the Chinese profits?

PROBLEM 3

Trikeco, a domestic corporation, manufactures mountain bicycles for sale both in the United States and Europe. Trikeco operates in Europe through Trike1, a wholly owned Italian corporation that manufactures a special line of mountain bicycles for the European market.

In addition, Trike1 owns 100% of Trike2, a U.K. corporation that markets Trike1's products in the United Kingdom. At end of the current year, the undistributed earnings and foreign income taxes of Trike1 and Trike2 are as follows:

	Trike1	Trike2
Post-1986 undistributed earnings	\$90 million	\$54 million
Post-1986 foreign income taxes	\$36 million	\$27 million

During the current year, Trike2 distributed a \$10 million dividend to Trike1, and Trike1 distributed a \$10 million dividend to Trikeco. To simplify the computations, assume that neither dividend distributions attracted any Italian or U.K. withholding taxes, and that the dividend received by Trike1 was exempt from Italian taxation.

Compute Trikeco's deemed paid foreign tax credit, as well as the residual U.S. tax, if any, on the dividend Trikeco received from Trike1. Assume the U.S. tax rate is 35%.

PROBLEM 4

Shedco, a domestic corporation, operates in Asia through Shed1, a wholly owned Hong Kong subsidiary. At the end of the current year, Shed1's pools of post-1986 undistributed earnings and post-1986 foreign income taxes are as follows:

	Post-1986 <u>undistributed earnings</u>	Post-1986 foreign <u>income taxes</u>
General limitation income	\$24 million	\$18 million
Passive income	<u>\$12 million</u>	<u>\$3 million</u>
Totals	<u>\$36 million</u>	<u>\$21 million</u>

During the current year, Shed1 distributed a \$6 million dividend to Shedco. Compute Shedco's deemed paid foreign tax credit, as well as the residual U.S. tax, if any, on the dividend Shedco received from Shed1. Assume the U.S. tax rate is 35%.

PROBLEM 5

P is a domestic corporation. In each of the following independent scenarios, identify the foreign corporations (F1 through F4) for which P can claim a deemed paid foreign tax credit, assuming the foreign corporation's earnings are distributed up to P.

- P owns 50% of F1, F1 owns 50% of F2, and F2 owns 50% of F3.
- P owns 100% of F1, F1 owns 100% of F2, and F2 owns 9% of F3.
- P owns 100% of F1, F1 owns 100% of F2, F2 owns 100% of F3, and F3 owns 50% of F4. All the other shareholders of F4 are unrelated foreign persons.
- P owns 100% of F1 and 100% of F2. F1 owns 5% of F3, and F2 owns 5% of F3.

Chapter 5

PROBLEM

Tenco, a domestic corporation, manufactures tennis rackets for sale in the United States and abroad. Tenco owns 100% of the stock of Teny, a foreign marketing subsidiary that was organized in Year 1. During Year 1, Teny had \$15 million of foreign base company sales income, paid \$3 million in foreign income taxes, and distributed no dividends. During Year 2, Teny had no earnings and profits, paid no foreign income taxes, and distributed a \$12 million dividend.

Assuming the U.S. corporate tax rate is 35%, what are the U.S. tax consequences of Teny's Year 1 and Year 2 activities?

Chapter 6

PROBLEM 1

Beatco, an accrual basis domestic corporation, manufactures musical instruments for sale both in the United States and abroad. Beatco's functional currency is the U.S. dollar. Two years ago, Beatco established a branch sales office in Switzerland. The sales office qualifies as a qualified business unit with the Swiss franc (SF) as its functional currency. The branch's tax attributes for its first two years of operations are as follows:

	Year 1	Year 2
Taxable income	SF40 million	None
Foreign income taxes (paid at end of year)	SF15 million	None
Remittance to Beatco (paid at end of year)	None	SF25 million

The Swiss franc had an average daily value of \$0.50 during Year 1, \$0.65 during Year 2, and was worth \$0.60 at the end of Year 1, and \$0.75 at the end of Year 2.

What are the U.S. tax consequences of the branch's activities in Year 1 and Year 2?

PROBLEM 2

Joltco, a domestic corporation, manufactures batteries for sale in the United States and abroad. Joltco markets its batteries in Europe through its wholly owned foreign marketing subsidiary, Jolti. Jolti was organized in Year 1, and its functional currency is the pound (£). Jolti's tax attributes for its first two years of operations are as follows:

	Year 1	Year 2
Taxable income	£100 million	None
Foreign income taxes (paid at end of year)	£20 million	None
Net Subpart F income (included in £100 million)	£40 million	None
Actual dividend distributions (paid at end of year)	None	£8 million

The pound had an average value of \$1.50 during Year 1, \$1.65 during Year 2, and was worth \$1.60 at the end of Year 1, and \$1.70 at the end of Year 2.

What are the U.S. tax consequences of Jolti's results from operations in Year 1 and Year 2? Assume that the dividend distribution in Year 2 was not subject to foreign withholding taxes.

Chapter 7

PROBLEM

Acme, Inc., a domestic corporation, manufactures goods at its U.S. factory for sale in the United States and abroad. Acme has established an IC-DISC. During the current year, Acme's qualified export receipts are \$4,000, and the related cost of goods sold is \$2,400. Acme has \$1,200 of selling, general and administrative (SG&A) expenses related to the qualified export receipts. Acme's gross receipts from domestic sales are \$96,000, the related cost of goods sold is \$65,600, and the related SG&A expenses are \$18,800. In sum, Acme's results for the year (before considering any income allocated to its IC-DISC via a commission payment), are as follows:

	Total	Qualified export receipts	Other sales
Gross receipts	\$100,000	\$4,000	\$96,000
Cost of goods sold (direct material and labor)	<u>- 68,000</u>	<u>- 2,400</u>	<u>- 65,600</u>
Gross profit	\$32,000	\$1,600	\$30,400
SG&A	<u>- 20,000</u>	<u>- 1,200</u>	<u>- 18,800</u>
Net income	<u>\$12,000</u>	<u>\$400</u>	<u>\$11,600</u>

What is the maximum amount of income that Acme can allocate to its IC-DISC? (Assume combined taxable income equals the \$400 of net income from qualified export receipts.)

Chapter 8

PROBLEM 1

Growco, a domestic corporation, is a tire manufacturer. Growco is planning to build a new production facility, and has narrowed down the possible sites for this new plant to either Happystan (a low tax foreign country) or Sadstan (a high tax foreign country). Growco will structure the new facility as a wholly owned foreign subsidiary, Sproutco, and finance Sproutco solely with an equity investment. Growco projects that Sproutco's results during its first year of operations will be as follows:

Sales	\$400,000,000
Cost of goods sold	(290,000,000)
Selling, general and administrative expenses	<u>(60,000,000)</u>
Net profit	<u>\$50,000,000</u>

Assume that the U.S. corporate tax rate is 35%, the Happystan rate is 20%, and the Sadstan rate is 40%. Further assume that both Happystan and Sadstan impose a 5% withholding rate on dividend distributions, but neither country imposes withholding taxes on interest or royalty payments. Compute the total tax rate (U.S. plus foreign) on Sproutco's profits under the following assumptions:

- a. The new production facility is located in Happystan and Sproutco repatriates none of its profits during the first year.
- b. The new production facility is located in Happystan and Sproutco repatriates 30% of its profits during the first year through a dividend distribution.
- c. The new production facility is located in Sadstan and Sproutco repatriates none of its profits during the first year.
- d. The new production facility is located in Sadstan and Sproutco repatriates 30% of its profits during the first year through a dividend distribution.
- e. The new production facility is located in Sadstan and Growco modifies its plans for Sproutco as follows:
 - (i) finance Sproutco with both debt and equity, such that Sproutco will pay Growco \$15 million of interest each year,
 - (ii) charge Sproutco an annual royalty of \$10 million for the use of Sproutco's patents and trade secrets, and
 - (iii) eliminate Sproutco's dividend distribution.

What do the results of these various scenarios suggest regarding the differential tax costs of operating in low versus high tax countries?

PROBLEM 2

Six years ago, NewCo, Inc., a domestic manufacturer of mold-injection systems, established a sales and service operation in Madrid, Spain. The Madrid office was structured as a Spanish corporation, but NewCo made a check-the-box election to treat the operation as a branch in order to obtain a U.S. tax deduction for the branch's start-up losses. The Spanish operation has become quite profitable and NewCo wishes to change its U.S. tax classification from a branch to a subsidiary by filing a new check-the-box election (this is feasible since five years had passed since the first election). At the time of the conversion, the Spanish operation's assets includes some local currency, accounts receivable from Spanish customers, an inventory of spare parts, and an extensive database of information regarding Spanish customers that the marketing personnel had painstakingly developed over the years. NewCo's CFO has asked you to brief her regarding the U.S. tax consequences of the incorporation transaction. Briefly outline your response.

Chapter 9

PROBLEM

Hans, a citizen and resident of Argentina, is a retired bank executive. Hans does not hold a green card. At the start of Year 1, Hans paid \$2.5 million for a 20-unit apartment complex located in the suburbs of Washington, D.C. Hans does not actively manage the building, but rather leases it to an unrelated property management company that subleases the building to the tenants. During Year 1, Hans had rental income of \$300,000 and operating expenses (depreciation, interest, insurance, etc.) of \$220,000. On the advice of his accountant, Hans made a Code Sec. 871(d) election in Year 1.

At the start of Year 2, Hans sold the building for \$350,000. Hans' adjusted basis in the building at that time was \$290,000. What are the U.S. tax consequences of Hans' U.S. activities?

Chapter 10

PROBLEM 1

Cholati is a foreign corporation that produces fine chocolates for sale worldwide. Cholati markets its chocolates in the United States through a branch sales office located in New York City. During the current year, Cholati's effectively connected earnings and profits are \$3 million, and its U.S. net equity is \$6 million at the beginning of the year, and \$4 million at the end of the year. In addition, a review of Cholati's interest expense account indicates that it paid \$440,000 of portfolio interest to an unrelated foreign corporation, \$200,000 of interest to a foreign corporation which owns 15% of the combined voting power of Cholati's stock, and \$160,000 of interest to a domestic corporation.

Compute Cholati's branch profits tax, and determine its branch interest withholding tax obligations. Assume that Cholati does not reside in a treaty country.

PROBLEM 2

Wheelco, a foreign corporation, manufactures motorcycles for sale worldwide. Wheelco markets its motorcycles in the United States through Wheely, a wholly-owned U.S. marketing subsidiary that derives all of its income from U.S. business operations. Wheelco also has a creditor interest in Wheely, such that Wheely's debt to equity ratio is 3 to 1, and Wheely makes annual interest payments of \$60 million to Wheelco. The results from Wheely's first year of operations are as follows:

Sales	\$180 million
Interest income	\$6 million
Interest expense (paid to Wheelco)	(\$60 million)
Depreciation expense	(\$30 million)
Other operating expenses	(\$81 million)
Pre-tax income	<u>\$15 million</u>

Assume the U.S. corporate tax rate is 35%, and that the applicable tax treaty exempts Wheelco's interest income from U.S. withholding tax. Compute Wheely's interest expense deduction.

Chapter 11

PROBLEM

A foreign corporation can structure its U.S. operations as either a branch or a subsidiary. What are the tax advantages of operating in the United States through a separately incorporated subsidiary? What are the tax advantages of operating in the United States through an unincorporated branch? What general business factors should be considered when choosing between the branch and subsidiary forms of doing business in the United States?

Chapter 12

PROBLEM 1

In each of the following independent situations involving transfers of tangible property, determine which transfer pricing methods applies and compute a transfer price using the appropriate method. Show all of your computations.

- a. Dougco, a domestic corporation, owns 100% of Thaico, a Thailand corporation. Dougco manufactures top-of-the-line office chairs at a cost of \$300 per unit and sells them to Thaico, which resells the goods (without any further processing) to unrelated foreign customers for \$450 each. Independent foreign distributors typically earn commissions of 20% (expressed as a percentage of the sales price) on the purchase and resale of products comparable to those produced by Dougco.
- b. Clairco, a domestic corporation, owns 100% of Shuco, a foreign corporation that manufactures women's running shoes at a cost of \$30 each and sells them to Clairco. Clairco attaches its trade name to the shoes (which has a significant effect on their resale price), and resells them to unrelated customers in the United States for \$80 each. Independent foreign manufacturers producing similar running shoes typically earn a gross profit mark-up (expressed as a percentage of the manufacturing costs) of 15%.
- c. Tomco, a domestic corporation, owns 100% of Swissco, a Swiss corporation. Tomco manufactures riding lawn mowers at a cost of \$2,500 per unit, and sells them to unrelated foreign distributors at a price of \$3,750 per unit. Tomco also sells the equipment to Swissco, which then resells the goods to unrelated foreign customers for \$4,250 each. The conditions of Tomco's sales to Swissco are essentially equivalent to those of the sales made to unrelated foreign distributors.

PROBLEM 2

Mikco, a foreign corporation, owns 100% of Flagco, a domestic corporation. Mikco manufactures a wide variety of flags for worldwide distribution. Flagco imports Mikco's finished goods for resale in the United States. Flagco's average financial results for the last three years are as follows:

Sales	\$20 million
Cost of goods sold	(\$15 million)
Operating expenses	<u>(\$4 million)</u>
Operating profit	<u>\$1 million</u>

Flagco's CFO has decided to use the comparable profits method to assess Flagco's exposure to an IRS transfer pricing adjustment by testing the reasonableness of Flagco's reported operating profit of \$1 million. An analysis of five comparable uncontrolled U.S. distributors

indicates that the ratio of operating profits to sales is the most appropriate profitability measure. After adjustments have been made to account for material differences between Flagco and the uncontrolled distributors, the average ratio of operating profit to sales for each uncontrolled distributor is as follows: 6%, 8%, 10%, 10%, and 14%.

Using this information regarding comparable uncontrolled U.S. distributors, apply the comparable profits method to assess the reasonableness of Flagco's reported profits. In addition, if an adjustment to Flagco's reported profits is required, compute the amount of that adjustment.

PROBLEM 3

USACO, a domestic corporation, owns all of the stock of FSubco, a foreign corporation. FSubco manufactures widgets and sells them at a price of \$100 to USACO, which then resells the widgets to U.S. customers. USACO's gross receipts for the year are \$200 million. Under what circumstances would USACO be potentially subject to the Code Sec. 6662(e) substantial valuation misstatement penalty?

Chapter 13

PROBLEM 1

Stoolco, a domestic corporation, produces a line of low cost bar stools at its facilities in Missouri for sale throughout the United States. During the current year, Stoolco's management has decided to begin selling its stools overseas and has begun exploring the idea of establishing branch sales offices in some key countries in Europe and Asia. If possible, Stoolco's management would like to avoid establishing a taxable presence in these countries.

Stoolco's management has asked you to advise them on the types of marketing activities they can conduct within these countries without creating a taxable nexus. For purposes of this analysis, assume that the United States has entered into an income tax treaty with the countries in question that is identical to the United States Model Income Tax Convention of November 15, 2006.

PROBLEM 2

Erica is a citizen of a foreign country, and is employed by a foreign-based computer manufacturer. Erica's job is to provide technical assistance to customers who purchase the company's mainframe computers. Many of Erica's customers are located in the United States. As a consequence, Erica consistently spends about 100 working days per year in the United States. In addition, Erica spends about 20 vacation days per year in Las Vegas, since she loves to gamble and also enjoys the desert climate. Erica does not possess a green card. Assume that the United States has entered into an income tax treaty with Erica's home country that is identical to the United States Model Income Tax Convention of November 15, 2006.

How does the United States tax Erica's activities? How would your answer change if Erica were a self-employed technician rather than an employee?

Chapter 14

PROBLEM

Finco is a wholly owned Finnish manufacturing subsidiary of Winco, a domestic corporation that manufactures and markets residential window products throughout the world. Winco has been Finco's sole shareholder since Finco was organized in 1990. At the end of the current year, Winco sells all of Finco's stock to an unrelated foreign buyer for \$25 million. At that time, Finco had \$6 million of post-1986 undistributed earnings, and \$2 million of post-1986 foreign income taxes that have not yet been deemed paid by Winco. Winco's basis in Finco's stock was \$5 million immediately prior to the sale.

Assume Winco's capital gain on the sale of Finco's stock is not subject to any foreign taxes, and that the U.S. corporate tax rate is 35%. What are the U.S. tax consequences of this sale for Winco?

Now assume that instead of selling the stock of Finco, Winco completely liquidates Finco, and receives property with a market value of \$25 million in the transaction. As in the previous scenario, at the time of the liquidation, Finco had \$6 million of accumulated earnings and profits, and \$2 million of foreign income taxes that have not yet been deemed paid by Winco. Assume that Winco's basis in Finco's stock was \$5 million immediately prior to the liquidation, and that the U.S. corporate tax rate is 35%. What are the U.S. tax consequences of this liquidation for Winco?

Chapter 15

PROBLEM

For purposes of computing a corporation's state taxable income, do states generally permit a U.S. parent corporation to claim a dividends-received deduction for dividends received from a foreign country subsidiary?

Chapter 16

PROBLEM 1

USAco wholly owns a foreign subsidiary in Hong Kong called HKco. USAco sells HKco the seven components necessary to make sunglasses. Following one page of directions written in Chinese, HKco employees put the components together to make the sunglasses for HKco's sale throughout Europe. In order to determine whether USAco has any foreign base company sales income under Subpart F, the IRS needs to analyze whether HKco's activities constitute manufacturing.

What procedures can the IRS employ to gather the information needed to make this determination

PROBLEM 2

USAco is the wholly-owned U.S. subsidiary of ASIaco and USAco purchases automobiles from ASIaco for \$20,000. USAco resells the automobiles for \$21,000. The IRS conducts a transfer pricing examination of USAco and proposes an adjustment based on what it believes to be the arm's length transfer price of \$15,000. USAco decides to pursue the issue at both Appeals and Competent Authority under the Simultaneous Appeals Procedure ("SAP").

Describe the SAP procedures.