

# FDU: U.S. International Corporate Tax

- 1  **U.S. International Corporate Taxation**  
Stephen Fox, CPA, CMA  
www.sfoxcpa.com
- 2  **Basic Ground Rules**
  - Administrative matters
  - Course organization
    - Lecture, class discussions & exercises
    - Short paper (memo with calculations)
    - Midterm & final
  - Course-wide example facts
  - Question of the day: What is Confusion?
- 3  **Assumed Knowledge**
  - Basics of corporate tax
  - Basic knowledge of Subchapter C
    - 351, 332, reorganizations
  - Basic knowledge of consolidated returns
  - Very basics of partnerships
  - Some understanding of ASC 740 (SFAS 109)
- 4  **Recognition of Income**
  - Normal methods of accounting
  - Dividends recognized when paid
  - Special anti-deferral rules
    - Subpart F
    - PFIC
    - FPHC
  - Modified nonrecognition provisions
- 5  **Nexus to Tax**
  - U.S. can in theory tax anyone
  - Practical limits on collection
    - Other countries won't help
    - How to reach assets
  - General principles:
    - Tax only if some connection of person or income with US
    - Withhold tax where collection otherwise difficult
- 6  **Residents vs. Nonresidents**
  - Residents:
    - Taxed on worldwide income
    - Foreign tax credit
  - Nonresidents:
    - Taxed on U.S. source income
    - Graduated tax on U.S. ECI

# FDU: U.S. International Corporate Tax

- Withholding tax on FDAPI
  - Nonresident defined
- 7  **US vs. Foreign Persons:**  
**Residency under Law & Treaty**
  - Domicile for corporations
  - 183 day test for individuals
  - Tie breakers in treaties
- 8  **Taxation of Foreign Persons**  
**Graduated Tax on ECI**  
vs.  
**Withholding Taxes on FDAPI**
- 9  **Withholding tax on FDAPI**
  - 30% tax withheld by payor
  - Rate may be reduced by treaty
  - FDAPI includes
    - Interest
    - Dividends
    - Royalties
  - Rental may be ECI or FDAPI
- 10  **Effectively Connected Income**
  - Income EC with U.S. trade or business
  - Tax based on net taxable income
    - Graduated rates for individuals
  - Regular tax rules apply to determine amount
  - Some limitations apply to deductions
- 11  **Source of Income**
  - Function
  - Importance
- 12  **Source of Income**
  - Interest, Dividends: Residence of payor. Exceptions:
    - Interest from U.S.: 80% active foreign business = prorate
    - Dividends from foreign: over 25% U.S. business = prorate
- 13 
  - Rents & royalties: where property is used
  - Services: where performed
- 14  **Source of Income:**  
**Gain from Sale of Property**

# FDU: U.S. International Corporate Tax

- Resale inventory: title passage
  - Produced inventory: 50% title passage, 50% where produced
  - Recapture gains: where depreciation sourced
  - Stock: various sourcing
  - Residual rule: Residence of seller
- 15  Taxation of U.S. Rentals
- 30% tax on gross (FDAPI) vs.
  - Graduated tax on net (ECI)
  - Level of activity for trade or business
  - Election to be ECI: code vs. treaties
- 16  Foreign Tax Credit
- Foreign tax credit
    - Creditable taxes
    - Limitations on credit
    - Baskets of income
    - Look thru rules
  - Deemed paid credit
    - Corporation gets credit for taxes paid on underlying earnings of subsidiary paying dividends
- 17  Allocation & Apportionment
- Allocate deductions related to particular income
  - Apportion deductions related to multiple classes of income
  - Special rules apply to interest:
    - §1.861-8 et seq.: U.S. corporations apportion on assets; CFCs apportion on either assets or gross income
  - R&D apportioned either on sales or gross income
- 18  Subpart F
- CFC defined
  - 10% shareholders
  - 956 deemed dividend
  - 959 actual dividends
- 19  Subpart F income
- FPHCI
  - Sales & Services
  - Other
- 20  Other Outbound Topics
- FPHCs & other oddities
  - 1248
  - 367
  - 482
- 21  Source of Income

# FDU: U.S. International Corporate Tax

- Function of sourcing rules
  - Interest & Dividends: residence of payor
    - exceptions
  - Services: where performed
  - Rents: situs of property
  - Royalties: where intangible used
- 22  **Question #2 of the Day:**  
What do Pierre Boulez,  
Ken Linseman, Dairy Queen and  
Gumby have in common?
- 23  **Source of Services Income**
  - Generally: place of performance
  - \$3,000 de minimis rule
    - Of limited application
  - Situs of payor, where paid irrelevant
  - Residence of payee irrelevant
- 24  **Source of Services Income:**  
**Determining the Amount**
  - Amount allocated should be the amount earned for the services
  - Actual or pro-rata amounts
    - Daily prorata based on pay status days
    - Similar to New York formula
- 25  **Source of Deferred Comp.:**  
**Stock Options**
  - Place where services giving rise to option performed
  - Difficult factual questions
  - Ratable vesting
  - §83(b) election
- 26  **Source of Deferred Comp.:**  
**Qualified Plans, IRAs**
  - 3 components of distributions
    - Employer contribution sourced by where services performed
    - Employee contribution (after tax \$) exempt
    - Earnings on plan assets
      - US Plan: US Source
      - Foreign Plan: foreign source
  - Effect of portfolio interest exception
- 27  **Services vs. Other Income**

# FDU: U.S. International Corporate Tax

- Factual question as to what income is
  - Incidental services follow other function
  - Is construction services or sale of goods?
  - Guarantee fees
  - Noncompete agreements
  - Royalties
- 28  **Source of Rental Income**
- Place where property is used
  - Transportation rules
  - Other moveable property
- 29  **Source of Royalty Income**
- Place of use of intangible asset
  - Sale vs. License:
    - Significant factual questions
    - Dairy Queen cases
    - Gumby
  - Congress resolved issue for domestic but not international cases
- 30  **Answers to Question 2 of the Day:**  
What do Pierre Boulez,  
Ken Linseman, Dairy Queen and  
Gumby have in common?
- 31  **Source of Interest Income**
- Generally: residence of payor
    - Individual, estate or trust: residence
    - Corporation: place of incorporation
    - Partnership: place where partnership does business
  - U.S. interest excludes interest on deposits paid by foreign banking branch
  - Residency determined at time of payment
- 32  **Source of Interest Income:**  
**Definition of Interest**
- Same as rest of code
  - See §§483 & 163
  - Includes OID on notes in excess of 183 days
  - Includes imputed interest under §7872
  - Excludes market discount under §1276
- 33  **Source of Interest Income:**  
**Partnership Debtors**
- US source if partnership engages in US trade or business during year

# FDU: U.S. International Corporate Tax

- Classification issues become important

## 34 Source of Interest Income:

### Special Issues

- Guarantor: residence of guarantor (§861(a)(9))
  - U.S. source for foreign guarantor if debt is effectively connected
  - For guarantees issued after 9/27/10
- Individual residency determined under §7701(b) or treaty
- Residence of trust or estate is facts & circumstances
- US, state, & local government interest is US source

## 35 Source of Factoring Income

- Related person factoring income treated as interest on loan to obligor
- Results in U.S. source income from U.S. receivables
- Limited to:
  - FPHCs
  - Subpart F
  - FTC

## 36 Source of Dividend Income

- General rule: place of incorporation of payor
- Possessions corp. dividends are FSI
- U.S. source may include dividends from foreign corporation
  - If more than 25% of its gross income was U.S. ECI for
  - Preceding 3 years, then
  - Pro-rate dividend according to gross income

## 37 Question of the Day: Answers (?)

- 1. Sorry, I wasn't focusing. Ask the question again.
- 2. Wow!?!
- 3. Well, you know, it's, really, you know, uh, yeah.
- 4. Alfred E. Newman
- 5. International tax

## 38 Source of Income:

### Sale of Property

- Resale inventory: title passage rule
- Produced inventory: 50/50 rule
- Depreciable property: follows deductions
- Residual (general?) rule: residence of seller
- Other
- What is a sale? Includes "exchange or other disposition"

## 39 Source: Fixed Place of Business

- Residents: certain income is FSI if attributable to fixed place of business outside US

# FDU: U.S. International Corporate Tax

- Nonresidents: all income is USSI if attributable to fixed place of business in US
  - Exception: Does not apply to inventory for use outside US if foreign office materially participated

## 40 Sale of Purchased Inventory

- Title passage rule
- Where does title pass
  - Shipping terms
    - FOB
    - CIF
    - C&F
    - Ex Works
  - Explicit title passage

## 41 Sale of Purchased Inventory

- When does title pass
  - Bare title passage
  - Economic risk
  - Actual actions of parties contrary to contract
- Manipulation of sourcing rules

## 42 Mixed Source Rules: Overview

- US produced, foreign sold, or vice versa
- 50/50 Rule
  - 50% to place produced
  - 50% to where title passes
- Independent factory price
  - Elective
  - Special rules for post-production activity
- Natural resource rules

## 43 50/50 Rule

- Strict bifurcation:
  - 50% to production activity
  - 50% to sales activity: title passage rule
- Apportion production piece based on assets:
  - Include only production assets
  - Exclude inventory, receivables, warehouse, etc

## 44 50/50 Rule

- Apportions gross income, then deductions separately allocated
- Application is simple where no mixed situs production

## 45 Independent Factory Price

- IFP is a production-only price: designed to exclude marketing activity
- For an IFP to exist, the taxpayer must
  - Regularly sell part of output
  - To independent distributors in such way as to

# FDU: U.S. International Corporate Tax

- Fairly establish an IFP

## 46 Independent Factory Price, cont.

- Applies only to
  - Substantially similar inventory sold under
  - Substantially similar conditions in
  - Substantially similar geographic markets

## 47 Sale of Other Property

- Recapture items
- Gain on stock of affiliate
- Loss on stock of affiliate
- Contingent payment for intangibles = royalty
- Non-contingent goodwill
- Other intangibles

## 48 Computer Software Income

- 1.861-19
  - Treated as services if substantial custom modification
  - Treated as sale of item if no reproduction rights granted
  - Treated as license if reproduction rights granted

## 49 Source of Income:

### Items on Checklist

## 50 Withholding Taxes:

### General Rules

- 30% tax on gross income
- Rate reduced by treaties
- NO DEDUCTIONS
- Payor responsible for withholding, faces penalties for failure
- No return: Final tax (except compensation)

## 51 Withholding Tax:

### Income Subject to W/h

- US source FDAPI: interest, dividends, rents, royalties
- Other FDAPI
- Generally, any U.S. source income not effectively connected with trade or business
- What are wages?

## 52 When Withholding Applies

### 6 Step Test

- Recipient is “foreign” person
- Amount is U.S. source income



# FDU: U.S. International Corporate Tax

- FDAPI
  - Not ECI
  - Withholding agent involved
  - No applicable exceptions
- 53  **Who's Subject to Withholding**
- Nonresident alien individuals
    - Reliance on statements of residence
  - Foreign corporations
    - Charities?
  - Foreign fiduciaries
  - Foreign partnerships
    - What of partners?
- 54  **Withholding Procedures**
- Complex §1441 regulations
  - Withholding Agents
    - U.S. or Foreign
  - When to withhold
  - Who is subject to withholding
  - Forms, filing deadlines, payment
  - Cash basis
  - Qualified Intermediary rules
- 55  **Exceptions for Interest Income**
- Bank account interest §§871(i), 882(d)
  - Interest on portfolio debt, as defined §§871(h), 882(c)
    - Broader than it seems
- 56  **Exception for Interest Income:**
- 80% Foreign Business**
- FDAPI excludes interest received from a resident alien or domestic corp. meeting 80% foreign business test:
    - 80% of gross income is from
    - Active foreign business for
    - 3 years ending with preceding tax year
  - For 80% test, look thru related person interest
  - All or nothing basis: not prorated
  - Grandfather rule: still applies for U.S. holders of obligations issued before 8/10/10
- 57  **Effectively Connected Income**
- Defined
    - Income
    - Effectively connected with
    - U.S. trade or business
  - How taxed

# FDU: U.S. International Corporate Tax

- 58  ECI vs. FDAPI
- What level of connection required?
  - Services give rise to trade or business
  - Royalties
  - Trading in stocks
  - Trading in commodities: special rule
- 59  Doing Business
- What is doing business?
- Selling
    - Exceptions
  - Performing services
  - Rentals
  - Other business activities
  - See cases under §162
- 60  What is a Trade or Business?
- Level of activity important
    - occasional transactions not T or B
    - Regular, continuous & substantial
  - Must have revenue generating activity
    - Mere promotion is not T or B
    - Research is not T or B
  - Can be direct or indirect
    - Such as thru partnership or agent
- 61  What is a Trade or Business in US? Cases
- Linen Thread Co: a few sales: no T or B
  - European Naval Stores: no place of business
  - Scottish American Investment Co: clerical office is not place of business
- 62  Treaties
- General provisions
    - Residency
    - Taxes covered
    - Permanent establishment defined
    - Taxpayers covered
  - Nearly 50 US treaties in force
- 63  Treaties
- **Every treaty is different**
  - Typically reduce withholding rates on:
    - Dividends (often 5-15%)
    - Interest (often 0 )
    - Royalties (often 0 )

# FDU: U.S. International Corporate Tax

- Limits on taxation of ECI
  - Competent authority
- 64  **Treaties: Residency**
- Fiscal domicile vs. actual domicile
  - Corporations or businesses
  - Individuals
  - Tie breaker clauses
- 65  **Treaties: Permanent Establishments**
- PE is nexus level to tax
  - PE is:
    - Fixed
    - Place of
    - Business
  - Common inclusions & exclusions
- 66  **Fixed**
- Not moveable
  - Some degree of permanence
    - Not just a few weeks or months
  - Market stall can be fixed if assigned
  - Equipment constituting business need not be “fixture”
- 67  **Place**
- Some identifiable situs
  - Physical location defined
    - i.e., not “somewhere in the building”
- 68  **Of Business**
- Business must be conducted
    - Does not need to be even a material portion, just some
  - This generally means revenue generating activity
    - Sales office
  - Research or administrative office is not a place of business
- 69  **Agent’s Activities**
- Activities of an agent may be attributed to a principal
  - Generally requires that agent “regularly and habitually” exercise powers as agent
    - Thus occasional sales don’t count
  - Agent’s place and conduct of business may be attributed
    - Can create PE
  - Often exclusion for agents who are independent and acting in ordinary course of their business
- 70  **Agency Generally**
- General definition
  - Requires three parties

# FDU: U.S. International Corporate Tax

- Principal
- Agent
- Third party relying on agency
- Agency relationship may cause U.S. taxation

## 71 Agency:

### Authority to Bind

- No agency without authority to bind principal in contracts

## 72 Agency Relationships

- Express agency: by agreement
- Implied agency: by agreement or action of parties
- Ratification
  - By action of principal
  - Express or implied

## 73 Agency:

### Attribution of Activities

- Activities of agent may be attributed to principal
- This may cause US tax:
  - Permanent establishment
  - Doing business

## 74 Partnership as Agency

- Basic concept of partners is agents for one another
- Partners have ability to bind other partners
- Partners considered doing business in US thru PE if partnership does

## 75 Selling “Agents”

- Agent vs. sales rep
- Limited agency
- Avoiding agency

## 76 Independent Agents

- Activities of independent agent acting in ordinary course of business often not attributed to principal
- Ordinary course of business
  - Of the agent

## 77 Independent Agents

- Independence
  - Entrepreneurial risk of agent
  - Detailed control
  - Dependent agent need not have equity relationship

## 78 Dependent Agents

# FDU: U.S. International Corporate Tax

- Activities generally attributed to principal, but only if
- Activity is regular and continuous, and
- Activity is in name and for account of principal

## 79 Commissionaire

- Not an agent under civil law
- Acts like agent
- Provides insulation against tax of U.S. parent

## 80 Income Properly Attributable

- Intercompany pricing concepts apply
  - Consider functions and risks
- Likelihood of tax authorities challenging

## 81 Treaties

- Dispute resolution: Competent Authority
- Anti-double tax clauses

## 82 Treaties

- Common special provisions
  - Artistes & athletes
  - Scholars & trainees
- Oddities
  - UK ACT credit

## 83 Treaties: New Concepts

- Limitation on benefits clauses
  - Netherlands, Mexico, UK, Canada protocol
  - Prevents treaty shopping
  - New level of complexity
- Tax sparing

## 84 Treaty Shopping

- Not prohibited, but IRS hates
- Anti Treaty Shopping provisions in:
  - Branch profits tax
  - New treaties
- 7701(l) regulations:
  - Sham: Aiken and Rev. Ruls. 84-152 and 84-153
  - Recharacterization under regulations

## 85 Treaties: Info. Sources

- CCH treaties service: hard copy & CD
- IBFD: same (based in Amsterdam)
  - International Bureau of Fiscal Documentation
- In-Depth Publishing: Tax Treaties Service
  - Includes OECD model & commentary
  - Includes most rulings & cases for all OECD countries

# FDU: U.S. International Corporate Tax

- Rhodes & Langer: appendices
  - BNA portfolios
- 86  **Treaty Based Return Positions (TBRP): §6114**
- What is a TBRP?
    - Any position that reduces US tax if
    - The position is due to a treaty
  - Can have TBRP without any return required
- 87  **Reporting TBRPs**
- Any taxpayer with TBRP must report
  - If no return otherwise required, must file return just to report
    - Return may be 1040NR or 1120F with no info. but name, address, id# & 6114 schedule
  - Limited exceptions for items from affiliates reported on Form 1042S
- 88  **How to Report TBRP**
- Form 8833 attached to return showing:
    - “TBRP under §6114”
    - Name & ID # (if any)
    - Amount & type of income
    - Treaty country
    - Treaty article
    - Reason for reduction
- 89  **Penalty for Failure to Report TBRP**
- \$10,000 for corporation
  - \$1,000 for individual
  - Applies to each failure
  - Potential loss of all deductions