

# International Taxation

## Corporate and Individual

EIGHTH EDITION

### Volume 1

### Chapters 1–11

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“Remembering that I’ll be dead soon is the most important tool I’ve ever encountered to help me make the big choices in life. Because almost everything—all external expectations, all pride, all fear of embarrassment or failure—these things just fall away in the face of death, leaving only what is truly important. Remembering that you are going to die is the best way I know to avoid the trap of thinking that you have something to lose. You are already naked. There is no reason not to follow your heart.”

Steve Jobs (2005)

To my pyramid of life and to following my heart

Ruth,

Jennifer, Jessalyn, Eric, Matthew

Madison, Reid, Peyton

I love you!

PF



To the many pioneering women whose hard work and perseverance paved the way for my own, especially Verna Hoffer, Magdalen Shaffer Potts, Betty Hoffer, and Alice M. Batchelder. You were, are, and always will be heroes.

SRH





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# *Preface*

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## **Approach and Purpose**

The authors intend to meet two important goals. The primary goal is to provide the novice reader with a comprehensible explanation of the taxation by the United States of international transactions involving corporations, partnerships, and individuals. A secondary goal is to offer the experienced user a volume of timely, thorough, and practical reference material.

The area of international taxation is most complex, and the more difficult provisions within that area have been similarly described:

In keeping with the high level of complexity one has come to expect as a matter of course in the foreign tax area, the . . . provisions quickly reach, and rarely leave, a plateau of statutory intricacy seldom rivaled in other sections of the Code, thus, the provisions easily qualify as a “four star” example of Byzantine architecture in a statute not noted for its economy of line.<sup>1</sup>

While the quotation described the technically onerous DISC provisions, given the extensive and rapid developments occurring over the past decades, this comment aptly describes the entire field of interna-

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<sup>1</sup> Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 17.14 (4th ed. 1979).

tional taxation. As markets continue to globalize, international tax considerations multiply proportionately, if not exponentially. Moreover, Treasury is concentrating an ever-increasing level of resources and attention on international taxation issues and cross-border transactions. In light of these developments, it is particularly important that the practitioner possess a working knowledge of the international tax provisions of the United States.

Due to the volume of material in this area (and the authors' desire to retain a passing familiarity with family and friends), the treatise attempts to refer the reader to other research sources through the use of footnote references. The authors have attempted to review the major cases, rulings, and relevant articles in the area and to provide footnote citations for those sources. Such an approach is designed to assist in the research of a complex problem without detracting from the desired readability of the general text.

To preserve the benefits of this work, revisions will be published regularly, integrating recent cases, Rulings, and Regulations (final and proposed) as well as any legislative changes. Consequently, the treatise will grow in depth and scope with the passage of time.

## Coverage

The treatise discusses in detail the international tax consequences, from a United States perspective, of transactions carried out by individuals, partnerships, and corporations, as well as those occurring between partnerships and corporations and their owners. The tax treatment of trusts and estates and their beneficiaries is not addressed.

The text focuses on two situations: (1) the United States taxation of United States individuals, partners, and corporations with respect to income arising from without the United States, i.e., "outbound transactions," and (2) the United States taxation of their foreign counterparts on both their United States and foreign source income, i.e., "inbound transactions."

Generally speaking, domestic individuals (i.e., citizens and residents), partners, and corporations are subject to United States taxation on all income, whatever its source. Thus, the United States tax rates are applied regardless of whether the income is derived in one of the 50

states, in the District of Columbia, or in any foreign country.<sup>2</sup> However, any taxes which the domestic individual, partner, or corporation pays to a foreign jurisdiction may qualify for either a deduction or a credit against the United States tax liability,<sup>3</sup> and certain foreign source earnings may be exempt from United States taxation.<sup>4</sup>

In contrast to the tax treatment of domestic individuals, partners, and corporations, a foreign individual, partner, or corporation is not, by virtue of any *in personam* nexus, subject to tax by the United States. Foreign individuals, partners, and corporations are subject to United States taxation only if they derive income from within the United States (i.e., United States source income) or if they derive income which is effectively connected with a United States business.<sup>5</sup> Complete United States taxation of this income, however, is mitigated by Code provisions intended to encourage foreign investment in the United States (such as § 871, which either eliminates or lowers the domestic tax rate to 30 percent on certain investment income) or by bi-lateral tax treaties.<sup>6</sup>

## Legislative Changes

The tax acts of the last decades generated a number of changes in the international tax area. This text generally focuses on current law, touching only briefly on prior law where it is deemed significant.

## Abbreviations and Terms

In this text, *section* or § refers to sections of the United States Internal Revenue Code; *Regulations* or *Reg.*, *Proposed Regulations* or *Prop. Reg.*, *Temporary Regulations* or *Temp. Reg.* refer to Treasury Department Regulations; *Revenue Ruling* or *Rev. Rul.* refers to Rulings published by the Internal Revenue Service; *Private Letter Ruling* or *Priv. Let. Rul.* refers to Private Letter Rulings issued by the Service; *Technical Advice Memorandum* or *Tech. Adv. Memo.* refers to Technical Advice Memoranda issued by the Service; and *Revenue Procedure* or *Rev. Proc.* refers to Revenue Procedures published by the Service. A *domestic*

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<sup>2</sup> IRC §§ 1 and 11.

<sup>3</sup> IRC §§ 164 and 901–908. See discussion at chapter 6.

<sup>4</sup> IRC § 911. See discussion at chapter 3.

<sup>5</sup> See discussion at chapters 17–19.

<sup>6</sup> See discussion at chapters 13–15.

*person* or *United States person* refers generically to United States corporations, partners, citizens, and residents. A *foreign person* refers to a non-resident individual, partner, or a foreign corporation.

## Relevant Dates and Reader Input

This work is current through December 31, 2012. Future developments will be covered in forthcoming chapter revisions. Readers are encouraged to make suggestions and comments which will be reflected in future editions.

## Acknowledgments

We thank those instrumental in the successful preparation and completion of this work. Their assistance was invaluable and deeply appreciated. Particular thanks is extended to Barry Quirke and Lowell Yoder who are partners at McDermott Will & Emery specializing in international taxation. Through their patience and guidance in teaching courses in Advanced International Taxation and Controlled Foreign Corporations at the Northwestern Tax Program we were introduced to the intersection of geometry and international taxation. As a consequence, we have attempted in the Sixth Edition to incorporate a more modern approach into the text. While our efforts pale by comparison to what they displayed in the classroom, we are building upon their foundation and, like fine wine, hope to improve with age. We can never thank them enough for permitting us to observe first-hand their introduction to life as an international tax lawyer.

Additional thanks is due Olugbenga Ishmael and Gabriella Olteanu who served as our research assistants in the course of the revision. Their assistance, rendered under less than ideal circumstances, improved the quality of the finished work.

The editorial staff at CCH, a Wolters Kluwer business was most helpful and professional. We especially thank Linda Barnich and Jennifer Schencker for their patience, diligence, and exacting attention to detail and their willingness to participate in a “triple loop” of the work.

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# International Taxation

## Corporate and Individual

EIGHTH EDITION

### Volume 2

### Chapters 12–22

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“Remembering that I’ll be dead soon is the most important tool I’ve ever encountered to help me make the big choices in life. Because almost everything—all external expectations, all pride, all fear of embarrassment or failure—these things just fall away in the face of death, leaving only what is truly important. Remembering that you are going to die is the best way I know to avoid the trap of thinking that you have something to lose. You are already naked. There is no reason not to follow your heart.”

Steve Jobs (2005)

To my pyramid of life and to following my heart

Ruth,

Jennifer, Jessalyn, Eric, Matthew

Madison, Reid, Peyton

I love you!

PF





To the many pioneering women whose hard work and perseverance paved the way for my own, especially Verna Hoffer, Magdalen Shaffer Potts, Betty Hoffer, and Alice M. Batchelder. You were, are, and always will be heroes.

SRH





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