United States International Taxation

United States International Taxation

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Volume 1

Chapters 1–13

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Why stay in college?
Why go to night school?
Will it be different this time?
Can't write a letter, can't send no postcard,
I can't write nothing at all.
This ain't no party, this ain't no disco,
This ain't no fooling around.
No time for dancing, or lovey dovey,
I ain't got time for that now!

"Life During Wartime"
by Talking Heads (1981)

The challenge of the End Game is getting it done; crossing off all of the items on one's to do list.

To those who keep adding items to my list.

PFP

It is solely because I think that it is the duty of those who know to recognize the unadvertised first rate, that I wish now to express my respect for [Professor Wigmore's] great learning and originality and for the volume and delicacy of his production, which seem to me to deserve more distinct and public notice than, so far as I am aware, they have received. I feel quite sure, from his printed work, that his teaching will satisfy the two-fold desire of man; that it will be enlightened with intelligent economic views and give men what they want to know when they go out to fight, but that also it will send them forth with a pennon as well as with a sword, to keep before their eyes in the long battle the little flutter that means ideals, honor, yes, even romance, in all the dull details.

Justice Oliver Wendell Holmes, Jr.
Dedication of the Northwestern University Law School Building
Chicago, October 20, 1902

To Professor Philip F. Postlewaite, who founded the Graduate Tax Program at Northwestern University School of Law and whose voluminous printed work, learning, and contagious work ethic are, in my view, equally deserving of the same high praise.

MBW

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Preface

Approach and Purpose

With this treatise, the authors intend to accomplish two important goals. The primary goal is to provide the novice reader with a comprehensible explanation of the United States tax consequences of international activities and transactions involving corporations, partnerships, and individuals. A secondary goal is to provide the experienced practitioner with volumes of timely, thorough, and practical reference material.

The area of international taxation is most complex, and the more difficult provisions within this 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.[1]

While the quotation described the technically onerous DISC provisions, given the extensive and rapid developments that have occurred over the last several decades, this comment now aptly describes the entire field of international taxation. The ever-increasing complexity in this area of the tax law is, at least in part, attributable to the intense global competition that has swept throughout the world over the last 35 years. With the enactment of the Tax Cuts and Jobs Act of 2017, Congress entered the fray by significantly altering the taxation of international 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 Internal Revenue Code.

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 a vast array of primary and secondary authorities 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, this treatise will grow in depth and scope and, like a fine bottle of cabernet sauvignon, will hopefully improve with age.

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

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 and among partnerships, corporations, and their owners. The tax treatment of trusts and estates and their beneficiaries is not addressed.

The treatise is organized around the two fundamental spheres of United States international taxation: (i) the United States taxation of United States individuals and corporations with respect to income arising outside the United States, i.e., "outbound transactions," and (ii) the United States taxation of their foreign counterparts with respect to their United States and foreign source income, i.e., "inbound transactions."

Generally speaking, United States citizens, residents, and corporations are subject to United States tax on all income, from whatever sources derived. Thus, the United States tax rates are applied regardless of whether the income is derived in any one of the 50 states, in the District of Columbia, or in any foreign country.[2] However, taxes paid to a foreign jurisdiction may qualify for a deduction or a credit against the United States tax liability,[3] and certain foreign source earnings may be exempt or effectively exempt from United States tax altogether.[4]

In contrast to this worldwide taxing framework foisted on United States persons, foreign individuals and corporations are not subject to United States tax by virtue of any *in personam* nexus. Rather, foreign individuals and corporations are subject to United States tax only if they derive income from sources within the United States or derive income that is effectively connected with a United States business.[5] 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 in certain circumstances eliminates the domestic tax rate on certain investment income) and by bilateral tax treaties.[6]

Legislative Changes

The tax acts of the last several decades generated a number of changes in the international tax arena. This text generally focuses on current law, touching only briefly on prior law where it adds helpful insights into the current state of play.

Abbreviations and Terms

Throughout this treatise, *Code* refers to the Internal Revenue Code of 1986, as amended from time to time; *Service* refers to the Internal Revenue Service; *section* or *§* refers to sections of the Code; *Regulations* or *Reg.*, *Proposed Regulations* or *Prop. Reg.*, and *Temporary Regulations* or *Temp. Reg.* refer to Treasury Department Regulations; *Revenue Ruling* or *Rev. Rul.* refers to Rulings published by the Service; *Private Letter Ruling* or *Priv. Let. Rul.* refers to Private Letter Rulings issued by the Service; *Technical Advice Memorandum* or

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2. IRC §§ 1 and 11.
3. IRC §§ 164 and 901–908. See discussion at chapter 8.
4. IRC §§ 911 and 245A. See discussion at chapters 3 and 6.
5. See discussion at chapters 19–21.
6. See discussion at chapters 15–17.

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 *United States person* refers generically to domestic corporations, partnerships, citizens, and residents. It does not encompass non-resident individuals, foreign partnerships or foreign corporations.

Relevant Dates and Reader Input

This work is current through May 30, 2021. What once occupied a backwater area of the Code has for some time now taken center stage. International tax law now bristles with activity and developments domestically and internationally. As these developments are incorporated into the United States international tax law, the scope and contours of this treatise will expand and conform accordingly. Readers are encouraged to participate in this dialogue by submitting their edits, comments, corrections, criticisms, castigations, and helpful encouragements.

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Philip F. Postlewaite
Mitchell B. Weiss
Chicago, Illinois

Introduction

Overview

Accelerating advances in information technology, together with the deregulation of the financial and capital markets, have redefined the free market's competitive landscape. Today, it is just as easy to enter into a cross-border transaction as it is into a local one. Either option is just a click away—with such effort awakening the wheels of globally interlinked supply chains. While some may point to Brexit as marking the beginning of the end of globalization, the reality is that it is a fool's errand to believe you can disconnect an already globally interconnected world. The costs of cross-border transactions may rise with the current protectionist tide, but additional cross-border transactional costs will only place an added premium on providing effective international tax planning advice.

In this treatise, the United States tax rules applicable to "outbound" (Volume 1) and "inbound" (Volume 2) transactions and investments are discussed. An outbound transaction is one in which a United States person conducts business and/or investment activities abroad, e.g., when a United States citizen invests in an interest bearing bank account in Switzerland or a Delaware corporation sells shoes in Argentina. Conversely, an inbound transaction is one in which a foreign person conducts business and/or investment activities in the United States, e.g., when a Swiss resident invests in an interest bearing bank account in the United States or a Japanese corporation sells wine in the United States. Both outbound and inbound transactions may be affected by one or more of the 65 bilateral tax treaties the United States has signed. Thus, the effect these tax treaties have on the default domestic tax rules also must be addressed.

Some Fundamental Questions

In deciding how to tax outbound cross-border transactions, every country must answer a series of fundamental policy and pragmatic questions when designing its international tax laws. These questions include the following:

1. How should the taxing system distinguish domestic taxpayers from foreign taxpayers?
2. Should domestic taxpayers be subject to tax on their worldwide income or should they be fully or partially exempt from taxation on income derived outside their country of residence, i.e., a so-called territorial or quasi-territorial basis of taxation?
3. If a worldwide taxing framework is adopted, should a deduction or credit be granted for the foreign taxes imposed on the domestic taxpayer's income?

4. If a territorial or quasi-territorial taxing framework is adopted, what protective measures should be imposed to prevent the erosion of the home country's tax base?
5. What are the likely economic and political ramifications of the country's international tax system?

In addressing these questions with respect to corporate entities, the United States has drawn a sharp distinction between domestic corporations and foreign corporations. A domestic corporation (sometimes referred to as a "United States corporation") is any corporation which is created or organized in or under the laws of the United States.[1] A foreign corporation is any corporation which is not a United States corporation.[2]

From a policy standpoint, the propriety of this situs of formation demarcation may be questioned. It may be preferable, for example, to view a Delaware corporation as a foreign corporation, rather than as a domestic corporation, if it conducts its activities and is managed and controlled in France. On the other hand, the advantage of the situs of formation test is that, as compared to other tests that could be employed, it is comparatively simple and objective in its application, at least in the case of a corporation created under the corporate law of one of the 50 states or that of a foreign country.[3] Thus, even though the situs of formation test generally focuses on merely where a corporation's charter is filed, rather than upon theoretically more meaningful economic and operational criteria, the test is arguably justified on grounds of administrative convenience.[4]

As regards the classification of individuals, a similar distinction is drawn between citizens and residents of the United States and nonresidents. Historically, an individual's classification turned on the relevant facts and circumstances with an emphasis placed on ascertaining whether the individual's economic and personal ties rested more closely in the United States or a foreign country. However, Congress eventually adopted more objective tests with a nearly exclusive focus on the time duration spent in the United States rather than on more subjective social or economic criteria. As in the corporate context, for better or for worse, this time-line approach appears premised on administrative ease and certainty.[5]

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1. IRC §7701(a)(4); Reg. §301.7701-5.
2. IRC §7701(a)(5); Reg. §301.7701-5. See discussion at chapter 1.
3. More complicated questions may arise in less formal situations in determining where an entity has been created or organized for §§7701(a)(4) and 7701(a)(5) purposes. See *Compagnie Financiere De Suez Et De L'Union Parisienne*, CtCls, 74-1 USTC ¶9254, 492 F2d 798 (1974) (entity was Egyptian, rather than French; hence not entitled to benefits of French tax treaty with United States); Priv. Let. Rul. 8305138 (contractual arrangement under Luxembourg law created entity taxable as corporation under §7701).
4. The threshold issue of whether a particular entity constitutes a corporation for tax purposes for many enterprises is governed by the check-the-box Regulations. See generally Willis, Postlewaite, and Alexander, Partnership Taxation, chapters 1, 3, and 21 (Warren, Gorham and Lamont, 8th ed. 2017 and Supp. 2021-2). See also discussion at chapters 1 and 14.
5. IRC §7701(b). See discussion at chapter 1. See also Reg. §301.7701-3(h). In the tax treaty context, the determination is typically one of facts and circumstances deciding whether the claimant is a resident as defined by the treaty. See discussion at chapters 5 and 15.

Taxation of Domestic and Foreign Individuals and Corporations

Domestic individuals and corporations are generally, though not entirely,[6] subject to United States tax on their worldwide income, wherever such income is derived.[7] Foreign individuals and corporations, on the other hand, are subject to United States tax only on income that is effectively connected to the conduct of a trade or business in the United States and certain other specified types of income derived from United States sources.[8] A resident of a treaty country, however, is subject to United States tax only on income that is attributable to a permanent establishment in the United States and certain other income addressed by the governing tax treaty.

Foreign Tax Credit

The United States generally regards the country from which an item of income is sourced as having the primary right to tax the income.[9] Given the ubiquity of cross-border transactions and the worldwide taxing framework generally adopted by the United States, United States corporations and individuals are frequently subject to double taxation—by the United States on the person's foreign income and by the country in which the income is derived. The foreign tax credit mechanism mitigates much of this double jeopardy exposure.

If a domestic individual or corporation incurs a foreign income tax (or certain other types of foreign taxes) and the targeted income is also subject to United States tax, the taxpayer may claim a deduction or credit for some or all of the foreign taxes paid on the income. The credit is generally available and more valuable but limited to the extent the foreign tax does not exceed the United States tax that would have been imposed on the income had the credit not been available.[10] Thus, if a domestic corporation derives 20 percent of its taxable income from its foreign branch operations, its foreign tax credit generally may not exceed 20 percent of its tentative United States tax liability (computed before applying the foreign tax credit).[11]

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6. Two noteworthy exceptions are the § 911 foreign earned income exclusion for certain United States individuals and the 100 percent dividends-received deduction under § 245A for certain corporate domestic shareholders of foreign subsidiaries. See discussion at chapters 3 and 6, respectively.

7. IRC §§ 1 and 11(a); Reg. §§ 1.1-1(c) and 1.11-1(a).

8. IRC §§ 1, 11(d), 871, 881, 882, 1441, and 1442. Under § 897(a), gain or loss which is derived by a foreign individual or corporation from the disposition of a United States real property interest is deemed to be derived from the conduct of a United States trade or business. See discussion at chapter 21. Some foreign source income may be subject to United States tax. See discussion at chapter 20.

9. Under a relevant tax treaty, the country of income source may agree not to tax the income of corporations or individuals resident in the other signatory country in certain situations or may agree that it will tax such income only if certain conditions are present. The United States, for example, generally agrees not to tax the business profits of a foreign individual or corporation resident in a signatory country unless that taxpayer maintains a permanent establishment within the United States and such business profits are attributable to that permanent establishment. Tax treaties are discussed at chapters 5 and 15–17. Additionally, tax treaties frequently address the availability of the foreign tax credit.

10. IRC §§ 901–908. See discussion at chapter 8.

11. IRC § 904. This limitation is applied separately to four "baskets" of income: general, passive, foreign branch income, and global intangible low-taxed income. IRC § 904(d).

Foreign taxes incurred on a foreign corporation's earnings are not creditable when the earnings are distributed to the foreign corporation's domestic shareholders.[12] Except in limited circumstances, a foreign individual or corporation also may not claim a foreign tax credit on income that is subject to United States tax.[13]

Quasi-Territorial Corporate Taxing Regime

In December 2017, Congress enacted the most significant tax legislation since the Tax Reform Act of 1986 ("1986 Act"). Popularly known as the Tax Cuts and Jobs Act of 2017 ("TCJA"),[14] this legislation overhauled the international tax system by repealing, replacing, and materially altering more than 75 international provisions of the Code. Safe to say, today's international tax system is exponentially more complex and dynamic than its 1986 counterpart.[15]

In a sense, the impetus for the TCJA can be traced back to the 1986 Act. Widely heralded as a landmark legislative achievement, the 1986 Act is also infamous for setting in motion today's frenetic competition over the international corporate tax base—not necessarily a race to the bottom, but a competitive race nonetheless. Shortly after the United States slashed its corporate tax rate to 34 percent, nearly all other OECD countries followed suit, progressively lowering their corporate tax rates to the current average rate of approximately 24 percent. Meanwhile, the United States remained on the sidelines. In fact, the Clinton Administration increased the corporate tax rate to 35 percent, where it remained until the enactment of the TCJA.

The disparity in corporate tax rates, between the United States and the rest of the OECD world, created perverse incentives. A foreign subsidiary's active business profits were generally not taxed in the United States until such profits were repatriated to its domestic parent. When this occurred, the full 35 percent freight applied, less any foreign tax credits attending the repatriated earnings. Given the disparity in tax rates, however, repatriating a foreign subsidiary's offshore earnings often brought with it an incremental United States tax cost. This produced what is referred to as the "lock-out" effect, in which over time trillions of dollars of untaxed earnings became "trapped" in offshore subsidiaries.

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12. Prior to the enactment of § 245A, which is discussed in chapter 6, indirect foreign tax credits were available under former § 902 when ten percent domestic corporate shareholders received dividends from their foreign subsidiaries. See discussion at chapter 8. Corporate United States shareholders of controlled foreign corporations, however, may continue to credit the foreign taxes attributable to the amounts included in the shareholder's gross income under §§ 951(a)(1)(A) and 951A. See discussion at chapter 9.

13. IRC § 906. See discussion at chapter 20.

14. P.L. 115-97. To pass the Senate with a bare 51-vote majority, the tax bill had to comply with a budget reconciliation process and, with it, the so-called Byrd rule. This obscure parliamentary rule prevented the "Tax Cuts and Jobs Act" from being used as the bill's short-hand title. As a result, this major piece of tax legislation will forever go down in the annals of history as "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." See Aprill and Hemel, "The Tax Legislative Process: A Byrd's Eye View," 81 Law & Contemp. Probs. 99 (2018). The short-hand title, however, will be used throughout this treatise.

15. See Weiss and Postlewaite, Tax Cuts and Jobs Act Impact: Guide to International Tax (CCH 2018).

The lock-out effect also placed a premium on foreign-parented multinational structures which, in contrast to their United States parented counterparts, have never been subject to the worldwide United States tax net. To level the playing field, United States multinationals engaged in inversion transactions.[16] Through these self-help measures, a United States parent would become a subsidiary of a foreign corporation, either through a strategic acquisition or more brazenly through an internal restructuring. Other headwinds that ultimately led to the enactment of the TCJA included the shifting of valuable intangible property offshore through sophisticated migration planning techniques; eroding the United States tax base of foreign-parented multinationals through the lax and narrowly targeted earnings stripping rules; and the overarching threat to the United States tax base resulting from the OECD's base erosion and profit shifting ("BEPS") initiative and the European Union's implementation of certain BEPS recommendations. These headwinds, together with the Republican-controlled Congress and Administration, created the perfect storm for enacting major tax legislation without any Democratic support.[17]

The TCJA redressed the lock-out effect by permanently reducing the corporate tax rate to a flat 21 percent and by adopting a quasi-territorial corporate taxing regime. The new corporate tax rate brings the United States slightly below the average OECD corporate tax rate. The centerpiece of the quasi-territorial corporate taxing regime is § 245A, which provides a 100 percent dividends-received deduction ("participation DRD") for certain corporate United States shareholders of foreign corporations. A similar provision applies when, rather than distributing the foreign earnings, the corporate shareholder sells the shares of its foreign subsidiary. The intricacies of the participation DRD are discussed in chapter 6 and the requirements necessary to transition into this quasi-territorial corporate taxing regime are discussed in chapter 7.

Viewed in isolation, the shift toward a quasi-territorial corporate taxing system reflects a sea change in the international corporate tax landscape. Its significance, however, should not be overstated. As a backstop to the participation DRD, the TCJA also enacted numerous anti-deferral and anti-base erosion provisions,[18] which collectively hollow out many of the benefits of the participation DRD. These safeguard measures are essential to maintaining the integrity of the corporate tax system. Indeed, were it not for these measures, the participation DRD would have left a gaping hole through which much tax revenue would escape the United States tax net. Profits would be shifted to foreign subsidiaries located in low-tax or no-tax jurisdictions and then repatriated into the United States tax-free.

Safeguard Regimes

Because United States persons are generally subject to United States tax on their worldwide income while foreign corporations are generally not subject to such tax on income derived outside of the United States, the United States has enacted certain provisions applicable to foreign corporations owned by United States persons. These

16. See discussion at chapter 11.

17. For a discussion of the unusually partisan process that led to the enactment of the TCJA, see Graetz, "The 2017 Tax Cuts: How Polarized Politics Produced Precarious Policy," 128 Yale L J. Forum 315 (Oct. 25, 2018).

18. See IRC §§ 59A, 91, 163(j), 267A, and 951A.

provisions apply when the foreign corporation is either a controlled foreign corporation or a passive foreign investment company.[19]

Generally, these special taxing regimes are designed to prevent the deferral of United States tax through the formation or use of foreign corporations by United States shareholders. When a United States corporate shareholder is eligible for the participation DRD, these regimes prevent the outright avoidance of United States tax on much of the foreign corporation's earnings.[20] For example, assume that a United States corporation, X, establishes a foreign corporation, Y, to which X contributes $100. Y then deposits the $100 in a London bank account. Y will not be subject to United States tax on the interest income. However, under the controlled foreign corporation rules, interest earned on the $100 deposit (net of expenses) even though not distributed generally must be reported by X as ordinary income on its tax return.

Two general overlays to international transactions also must be considered. A special anti-abuse regime is set forth under § 367, which triggers the inherent gain in property transferred outside the borders of the United States to foreign entities.[21] Similarly, § 482 affords the Service a powerful tool to reallocate income, deductions, and credits between related parties if those parties fail to deal with each other at arm's length.[22] These provisions are broad and fairly unforgiving checks on the generosity of the United States as regards cross-border transactions in which potentially taxable income is being shifted outside of its reach by citizens, residents, and domestic corporations.

No Ruling Position of Service

Given the complex system described above, if possible, tax advisers would prefer to issue professional opinions and/or structure business transactions when they can be *certain* of the tax consequences. Provided certain specified procedures are followed and information submitted, the Service will issue a Private Letter Ruling to a taxpayer stipulating to the tax consequences of the proposed transaction. The Private Letter Ruling will bind both the taxpayer and the Service provided the facts as submitted in the request are consistent with those of the transaction as *actually* structured. Revenue Procedure 2021-1. provides a detailed listing of the procedural and factual requirements for such a request.[23]

Additionally, the Service annually issues a Revenue Procedure which provides an updated list of issues under the jurisdiction of the associate chief counsel (international) on which the Service will *not* issue guidance through the issuance either of an advance letter ruling or a determination letter.[24] The purpose of this no ruling Revenue Procedure is to alert taxpayers and their advisers of those topics which are off limits for discussion. However, the topics listed in the Revenue Procedure also alert the practicing bar of controversial issues on which the Service is unwilling to announce its position publicly

19. IRC §§ 951–964 (controlled foreign corporations) and §§ 1291–1297 (passive foreign investment companies). See discussion at chapter 9 and chapter 10, respectively.

20. The TCJA primarily addressed this concern by enacting § 951A, the global intangible low-taxed income regime, which is discussed in chapter 9.

21. See discussion at chapters 11 and 22.

22. See discussion at chapters 12 and 23.

23. Rev. Proc. 2021-1, 2021-1 IRB 1.

24. See Rev. Proc. 2021-7, 2021-1 IRB 290.

as well as those in which the Service is prone to challenge a taxpayer's actions. Thus, a survey of these topics can be most informative from either standpoint.

The Revenue Procedure is divided into five sections. The first section describes its general purpose and alerts taxpayers to significant changes from the prior year's no ruling Revenue Procedure. In many ways, the new sections are most revealing, since they suggest the latest hot button topics in the international area.

Section 3 of the procedure identifies questions, problems, and general areas on which the Service will not rule *under any circumstances*.

Section 4 lists areas in which letter rulings will not *ordinarily* be issued. However, the Revenue Procedure notes that exceptions will be made where unique and compelling reasons justify the issuance of a letter ruling. Even if a taxpayer concludes that his or her situation is unique, he or she is put on notice that the matter should be discussed with the Service prior to submission of an official request.

As indicated by the many issues on which the Service will not (or generally will not) rule, taxpayers and their advisers considering such transactions or structures generally will not enjoy the option of receiving the guidance and the blessing of the Service. Additionally, taxpayers acting in these areas should be prepared for greater scrutiny of such a transaction by the Service than would normally occur.

World Becomes Geometric

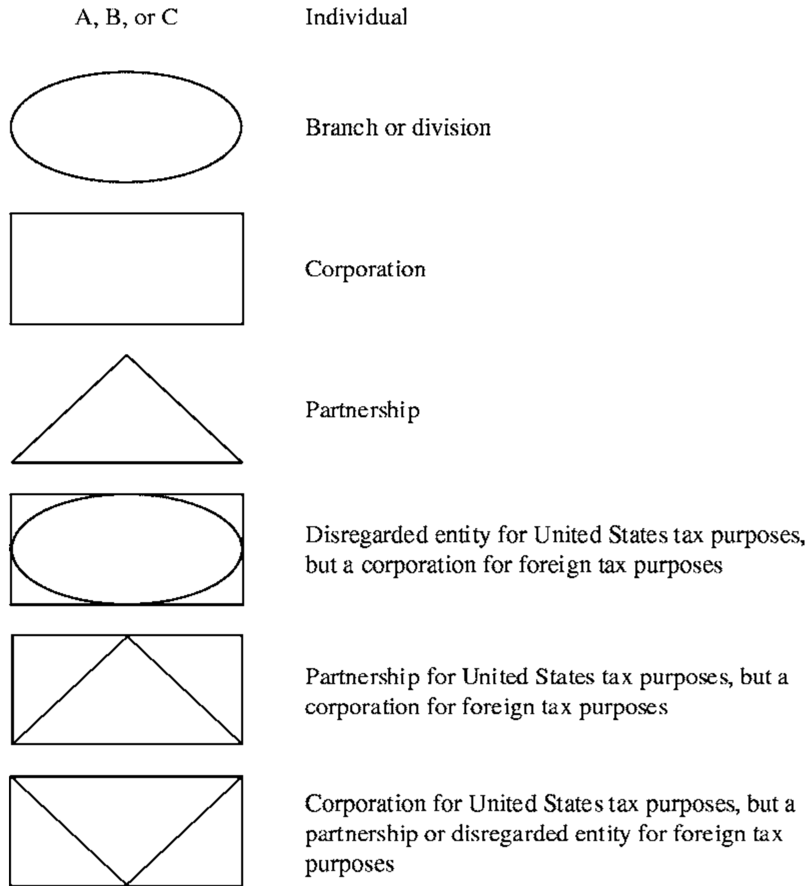
As the number of commercial transactions involving international tax transactions has increased exponentially over the last several decades, their depiction diagrammatically is replete with geometric symbols. Much of this is attributable to the check-the-box Regulations and the resulting schizophrenic classification of entities, i.e., those which are treated for tax purposes by one jurisdiction as a separate entity (a corporation) and by the other jurisdiction as a conduit entity (a partnership, a branch, or a division).[25]

In the offices of international tax practitioners, typically on whiteboards, computers, and powerpoint presentations, the world of geometry comes alive as proposed structures are scrutinized, amended, rejected, or embraced. Thus, a mathematical language has arisen in which geometric symbols represent entities to be employed in the proposed transaction and their characterization for United States tax purposes.

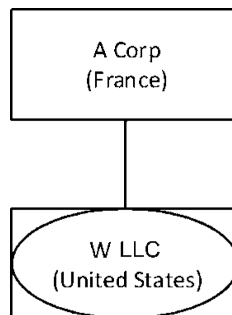
As presented below, various geometric shapes, ranging from the oval to the triangle to the rectangle, represent the tax status of various enterprises. While the legend presented below is that which will be used in this treatise, it is imperative, particularly when working with foreign lawyers, that all parties are using the symbols consistently. For example, some European practitioners employ the oval to represent a permanent establishment. From the perspective of a United States tax practitioner, the oval typically represents a branch or a division. While such can constitute a permanent establishment depending upon the governing facts and circumstances, not all constitute a permanent establishment. Thus, the cautious practitioner should start with some basic ground rules to which all parties agree regarding the meaning of the various geometric symbols which appear in the structure being considered.

The geometric shapes employed in this treatise are set forth below. It should be noted that these symbols appear nowhere in the Code or Regulations.

25. See discussion at chapters 1 and 14.



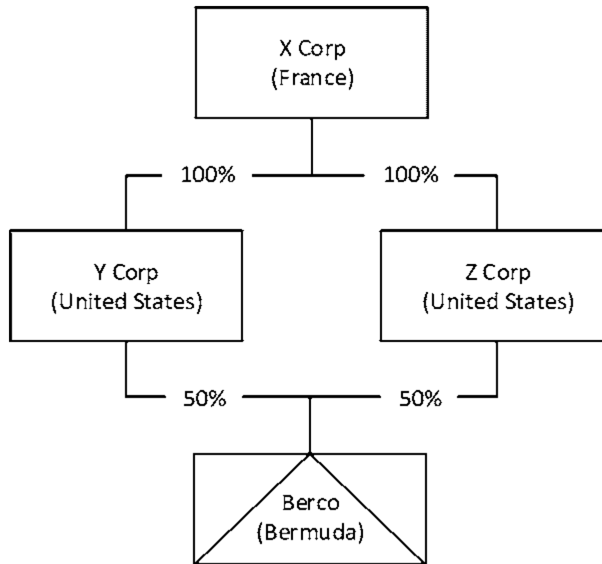
Typically, such symbols will not appear alone but will be accompanied by other symbols. As a consequence, it is important to indicate the relevant jurisdictions involved. For example, if domestic Corporation A formed a French subsidiary enterprise, Corporation W, which elected to be a disregarded entity for United States tax purposes, the diagrammatic presentation would appear as follows:



While not universally followed,[26] there is a growing preference to depict the ownership structure in a top-down fashion. For example, assume domestic Corporation X wholly

26. It is also not uncommon for an arrow to indicate the direction of ownership.

owns two French subsidiaries, Corporations Y and Z. If Corporations Y and Z equally own Berco, a Bermuda corporation that elects to be treated as a partnership for United States tax purposes, the ownership structure would appear as follows:



By scrutinizing the diagram, one can conclude that a domestic corporation wholly owns two French corporations that equally own a Bermuda "hybrid entity," i.e., an entity treated as a partnership for United States tax purposes but as a corporation for foreign tax purposes. If the triangle stood on its head, Berco would be a "reverse hybrid entity," i.e., an entity treated as a corporation for United States tax purposes but as a partnership for foreign tax purposes.