THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

Specimen Examination Paper

PAPER III

PRINCIPLES OF CORPORATE AND INTERNATIONAL TAXATION

A - UNITED STATES OPTION

TIME ALLOWED - 3 HOURS

Candidates should answer any **two** questions from Part I and any **two** questions from Part II.

Each question will carry equal marks.
Start each answer on a fresh sheet.
All workings should be made to the nearest month and dollar unless the question requires otherwise.
Marks are specifically allocated for good presentation.

General Note

In each of the questions, assume for purposes of simplicity that the normal United States tax income rate is 40% for individuals and 35% for corporations (the approximate maximum rates under current law) and that all net income is taxed at those rates. The statutory withholding tax rate, where applicable, is 30%. Unless otherwise indicated, assume further that there is no bilateral income tax treaty in force between the United States and any other country referred to in the questions. Where possible to do so, calculate the exact tax impact of your analysis. You are required to consider Federal taxes only and to ignore any possible implications of state taxes.

Assume in each case that there are no other transactions in the taxable year that affect your answer. If you find that a question is ambiguous or that you do not have sufficient data to answer it, respond to the question and explain the nature of the ambiguity or describe the missing information.

PART I

You are required to answer **TWO** questions from this Part.

1. A Inc, a chemical corporation organised under the laws of Industria, enters into a nonexclusive licensing agreement with B Co, a corporation organized under the laws of Freedonia, pursuant to which B Co, is entitled to use a worldwide system of patents developed and owned by A Inc. Even though A Inc conducts no business operations in the United States, it has purchased a number of US patents from US companies that are included in the licensing agreement with B Co. Under the licensing agreement, B Co must pay royalties equal to 10% of the profits attributable to the exploitation of the patents. During the tax year, B Co earns $20,000,000 from the use of the technology, half of which is attributable to B Co's business in the United States, and pays a royalty of $2,000,000 to A Inc.

   You are required to prepare a memorandum analysing the United States tax implications for A Inc and B Co. How, if at all, would your answer change if A Inc. sold the patents to B Co. under a contract providing that the sales price would be equal to 10 percent of the profits attributable to their exploitation?

   (25)

2. C Corp, a corporation organised under the laws of Agricola, receives $20,000 in dividends from D Inc, a US corporation operating only in the United States in which C Corp owns shares of common stock; C Corp also realises a capital gain of $100,000 on the sale of some shares of D Inc on the New York Stock Exchange; C Corp also receives interest payments of $10,000 on registered bonds issued by E Ltd, a US corporation operating only in the United States in which C Corp owns no equity interest.

   You are required to write a memorandum analysing the United States tax implications of the three transactions. How, if at all, would your answer change if C Corp implemented the transactions through a New York broker vested with the discretionary power to buy and sell stock without consulting C Corp?

   (25)

3. F Corp, a corporation organized under the laws of Industria, regularly sends sales staff into the United States to travel around the country and visit with potential customers. The sales staff live in hotels while in the United States but remain in close contact with customers by telephone and e mail when they have returned to Industria. When product is sold to US customers, arrangements are made by F Corp for delivery directly to the customers in the United States. All risks of loss and costs of transportation are borne by F Corp. During the course of the tax year, F Corp realises net income of $10,000,000 from the sales.

   You are required to explain the United States tax consequences for F Corp and its sales staff. How, if at all, would your answer change if F Corp were a corporation organised under the laws of the United Kingdom and entitled to the benefits of the UK-US Income Tax Treaty?

   (25)

4. George, a citizen and resident of Montagna, is an equal partner with Harry, a US citizen, in a consulting firm operating out of a Miami USA office and servicing clients located in Florida. Under the terms of the partnership agreement, George and Harry are to share equally in profits and losses. During the course of the year, George devotes 100 days to the venture, but works primarily at home in Montagna and communicates with his partner and his clients by telephone and fax. In fact George is actually in the United States only ten days during the year. During the year the partnership earns net income of $200,000, all of which is reinvested in the business and none of which is distributed to the partners. George has no other economic involvement in the United States.

   You are required to analyse the United States tax implications for George and Harry.

   (25)

PART II

You are required to answer **TWO** questions from this Part.

5. I Corp, a United States corporation, owns 50% of the stock of J Inc, a corporation organised under the laws of Freedonia. The remaining shares are owned by Keith, a citizen and resident of Freedonia. During its first year of operation in Freedonia, J Inc. has gross income of $2,500,000 and business expenses other than taxes of $1,300,000. In addition, J Inc pays real estate taxes of $200,000 in Freedonia and Freedonia income taxes of $200,000. J Inc pays a dividend in that year of $100,000 to each of its shareholders.

   You are required to prepare a memorandum analysing the United States tax implications for I Corp, J Inc and Keith. How, if at all, would your answer change if Keith were a citizen of the United States residing in Freedonia?

   (25)

6. L Ltd., a US corporation, operates branches engaged in the manufacture and sale of products in three countries as well as the United States. During the tax year, L Ltd. earned net income before income taxes of $1,000,000 in each of three countries: the United States, Agricola and Industria. However, L Ltd. lost $1,000,000 in Montagna. As a result of its operations, L Ltd. paid income taxes of $100,000 in Agricola and $300,000 in Industria. Of course, it had no income tax liability in Montagna.

   You are required to explain the United States tax implications of L Ltd. How, if at all, would your answer change if the operations in Agricola, Industria and Montagna had been implemented through the use of wholly-owned subsidiaries organized, respectively, in the three countries.

(25)

7. Maurice, a US citizen, works during the entire year in an oil field in Sandalia for a Sandalian company. Maurice is paid a salary of $100,000 and pays income taxes to Sandalia in respect thereof of $15,000.

   You are required to prepare a memorandum explaining the United States tax implications for Maurice. How, if at all, would your answer change if M were to take a two-month vacation each year in Miami?

(25)