

Nutshell Series

International Taxation

in a
nutshell®

RICHARD L. DOERNBERG

10TH EDITION

 WEST
ACADEMIC
PUBLISHING

INTERNATIONAL TAXATION IN A NUTSHELL®

TENTH EDITION

RICHARD L. DOERNBERG
Emeritus Professor of Law
Emory University School of Law

 **WEST
ACADEMIC
PUBLISHING**

The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional.

Nutshell Series, In a Nutshell and the Nutshell Logo are trademarks registered in the U.S. Patent and Trademark Office.

COPYRIGHT © 1989, 1993, 1997, 1999 WEST PUBLISHING CO.

© West, a Thomson business, 2001, 2004, 2009

© 2012 Thomson Reuters

© 2016 LEG, Inc. d/b/a West Academic

444 Cedar Street, Suite 700

St. Paul, MN 55101

1-877-888-1330

West, West Academic Publishing, and West Academic are trademarks of West Publishing Corporation, used under license.

Printed in the United States of America

ISBN: 978-1-62810-555-1

WEST ACADEMIC PUBLISHING'S LAW SCHOOL ADVISORY BOARD

JESSE H. CHOPER

Professor of Law and Dean Emeritus,
University of California, Berkeley

JOSHUA DRESSLER

Distinguished University Professor, Frank R. Strong Chair in Law
Michael E. Moritz College of Law, The Ohio State University

YALE KAMISAR

Professor of Law Emeritus, University of San Diego
Professor of Law Emeritus, University of Michigan

MARY KAY KANE

Professor of Law, Chancellor and Dean Emeritus,
University of California,
Hastings College of the Law

LARRY D. KRAMER

President, William and Flora Hewlett Foundation

JONATHAN R. MACEY

Professor of Law, Yale Law School

ARTHUR R. MILLER

University Professor, New York University
Formerly Bruce Bromley Professor of Law, Harvard University

GRANT S. NELSON

Professor of Law, Pepperdine University
Professor of Law Emeritus, University of California, Los Angeles

A. BENJAMIN SPENCER

Earle K. Shawe Professor of Law,
University of Virginia School of Law

JAMES J. WHITE

Robert A. Sullivan Professor of Law Emeritus,
University of Michigan

*To My Family, including Edie and Noa
who may one day like to see
their names in print
(when they learn how to read)*

PREFACE

For those who are or will be involved in international business and investment transactions, it is important to have some basic understanding of the relevant tax laws. This book is intended to serve as an introduction to the U.S. law of international taxation. It is primer aimed at law and accounting students, foreign tax practitioners or scholars, U.S. tax practitioners seeking an introduction to the area or a refresher, and others who might benefit from an overview of the U.S. tax laws governing international trade and investment. The book attempts to summarize the law, offering some attention to the purposes of the various legal rules. However, it is beyond the scope of the book to offer a critical evaluation of the provisions summarized or to delve deeply into tax planning structures and techniques. Actually practicing international tax in reliance solely on this primer could be hazardous to your career.

It will come as no revelation that the U.S. income tax laws are wondrously complex. Moreover, the student of U.S. international tax law should have some grounding in U.S. individual, partnership, state, employment and corporate tax principles. U.S. international tax does not exist in a vacuum. Knowledge of foreign tax systems is also useful. But realistically, many practitioners have their hands full trying to understand the U.S. system and collaborate with foreign colleagues on cross-border

transactions. Ironically it is because of the complexity that it is important to present a straightforward conceptual framework of the U.S. international tax provisions. Even with a framework, the intricate rules governing U.S. taxation of international transactions can be mind-numbing. Without an understanding of the structure of the U.S. international tax provisions (and often even with such an understanding), the rules are all but incomprehensible. Unfortunately, that is all too often the case even with an understanding of the structure.

To use this book effectively, it is helpful to have the Internal Revenue Code open at all times. If you are truly ambidextrous, you should have the Income Tax Regulations at hand as well. Frequent references are made to both the Code and the Regulations. There are some citations to caselaw and administrative rulings where they help illustrate the subject matter. However, the book is not a treatise, and so there is no attempt to treat comprehensively the caselaw and rulings.

To consider fully the international tax laws affecting international trade would require the study not only of U.S. international tax laws but also of foreign tax laws. However, such a study is beyond the scope of this book. So too is any consideration of the non-tax legal concerns affecting international transactions, including private international law, European Union law, the WTO, NAFTA, the internal laws of other nations, customs

law, tariffs, and non-tax international treaties. The tax laws of the individual states of the United States are not discussed. The focus here is on U.S. international tax laws and U.S. income tax treaties.

The book is divided into three Parts. After an introduction to the fundamentals of U.S. international taxation and the source rules, the second Part addresses the U.S. activities of foreign taxpayers—that is, investment and business activities carried on by nonresident individuals and foreign corporations in the United States. After a consideration of what a nonresident is for U.S. tax purposes, the basic U.S. jurisdictional tax principles are considered in this Part. Special attention is given to the branch profits tax and the provisions affecting foreign investment in U.S. real estate. Also included in this Part is a chapter on U.S. income tax treaties and a chapter on filing withholding and reporting requirements.

The third Part of the book is directed at foreign activities of U.S. citizens and residents—that is, investment and business activities of U.S. citizens and residents, including domestic corporations that generate income outside the United States. The centerpiece of this Part is a consideration of the U.S. foreign tax credit. This Part also discusses intercompany pricing, controlled foreign corporations, the treatment of foreign currency, and international tax-free transactions. There is also a chapter on tax arbitrage—the heart of much international tax planning. Those income tax

provisions regulating the “ethics” of U.S. business behavior abroad are also briefly addressed.

Hopefully, this book kindles an interest in international taxation. If it does, the reader must move beyond this primer into the maw of the Internal Revenue Code, Regulations, rulings and caselaw that make up the substance of U.S. international taxation. In addition, there are ample secondary sources that explore the subject more comprehensively.

The material presented is current through October 15, 2015 with occasional attempts to gaze into the tax crystal ball in order to anticipate likely changes to U.S. international tax law.

I would like to thank George Soba and Ivan Gutierrez for their contributions to Chapter 9 dealing with Intercompany Pricing. They have more years of experience in the intercompany pricing areas than they probably care to admit.

Please send any comments, suggestions or corrections to rdoernberg@gmail.com.

RICHARD L. DOERNBERG

Atlanta, Georgia
October 15, 2015

TABLE OF CASES

References are to Pages

ACM Partnership v. Commissioner	552
Aiken Indus., Inc. v. Commissioner	157
Altera Corp. v. Commissioner	338
Amoco Corp. v. Commissioner	248
Ashland Oil, Inc. v. Commissioner	378
Balanovski, United States v.	83
Bank of America National Trust & Savings Ass'n v. United States	244
Bank of America v. United States	37, 57
Bank of N.Y. Mellon Corp. v. Commissioner	549
Barnes Group v. Commissioner	555
Biddle v. Commissioner	248
Boulez v. Commissioner	40
Brown Group, Inc. v. Commissioner	381
Central Gas de Chihuahua, S.A. v. Commissioner	93, 182
Coltec Industries, Inc. v. United States	549, 552
Compaq Computer Corp. v. Commissioner	550
Cook v. Tait	23
Cook v. United States	39
De Amodio v. Commissioner	142
Del Commercial Properties, Inc. v. Commissioner	554
Derr, United States v.	329
Donroy, Ltd. v. United States	23, 80
Dover Corp. v. Commissioner	371
Exxon Corp. v. Commissioner	236
Goodyear Tire and Rubber Co., United States v.	264
Gregory, Helvering v.	551
Guardian Industries Corp. v. United States	545
H.J. Heinz Co. v. United States	549
Handfield v. Commissioner	82
Hawaiian Philippine Co., Commissioner v.	37
IES Industries v. United States	552
InverWorld, Inc. v. Commissioner	82, 87
Jones v. Commissioner	216
Karrer v. United States	39

Klamath Strategic Inv. Fund v. United States	549
Lewenhaupt v. Commissioner	81
Liggett Group Inc. v. Commissioner	46
National Westminster Bank, PLC v. United States	132, 148
Piedras Negras Broadcasting Co., Commissioner v.	38
Pinchot v. Commissioner	81
PPL Corporation v. Commissioner	236, 244
Procter & Gamble Co. v. United States	235
Rice's Toyota World v. Commissioner	552
Rogers v. Commissioner	217
Rousku v. Commissioner	217
Salem Fin. Inc. v. United States	549
Scottish American Investment Co., Ltd. v. Commissioner	81
SDI Netherlands B.V. v. Commissioner	43
Sergio Garcia v. Commissioner	45
Sochurek v. Commissioner	216
Spermacet Whaling & Shipping Co., Commissioner v.	83
Stenkowski v. Commissioner	39
Swallows Holding, Ltd. v. Commissioner	171
Taisei Fire & Marine Insurance Co., Ltd., et al. v. Commissioner	132, 144
United Parcel Service, Inc. v. Commissioner	552
Vetco Inc. v. Commissioner	378
Wells Fargo & Co. v. United States	552
Whitney v. Robertson	130
Wodehouse, Commissioner v.	105

TABLE OF INTERNAL REVENUE CODE SECTIONS

References are to Pages

26 U.S.C.A.

I.R.C. § 1.....	15, 18, 19, 115, 163
I.R.C. § 1(h)(11).....	361, 412
I.R.C. § 1(h)(11)(C)(iii).....	415
I.R.C. § 2(d).....	18
I.R.C. § 11.....	15, 18, 21, 22, 115, 117
I.R.C. § 11(d).....	18
I.R.C. § 61.....	181
I.R.C. § 78.....	265, 266, 268, 402, 406, 459, 509, 543, 547
I.R.C. § 82(c)(2).....	171
I.R.C. § 117.....	54, 179
I.R.C. § 162.....	60, 460, 479, 579
I.R.C. § 162(a)(2).....	57
I.R.C. § 162(c)(1).....	581
I.R.C. § 163.....	71, 332
I.R.C. § 163(j)(6)(D).....	103
I.R.C. § 164.....	579
I.R.C. § 164(a)(3).....	230, 240
I.R.C. § 165.....	560
I.R.C. § 168(g)(1)(A).....	16
I.R.C. § 197.....	546
I.R.C. § 199(a)(1).....	221
I.R.C. § 199(b)(1).....	221
I.R.C. § 199(c)(1).....	221
I.R.C. § 199(c)(4)(A).....	222
I.R.C. § 199(c)(5).....	222
I.R.C. § 212.....	460
I.R.C. § 243.....	16, 259
I.R.C. § 243(e).....	260, 267
I.R.C. § 245.....	260, 267
I.R.C. § 245(a)(8).....	267
I.R.C. § 245(b).....	267
I.R.C. § 267.....	469
I.R.C. § 267(a)(3).....	71, 546, 555

*TABLE OF INTERNAL REVENUE
CODE SECTIONS*

I.R.C. § 275(a)(4)(A)	230, 270
I.R.C. § 301(c)(1)	508
I.R.C. § 301(c)(2)	508, 547
I.R.C. § 304	484
I.R.C. § 316	264
I.R.C. § 318	359
I.R.C. § 318(a)(3)	359
I.R.C. § 331	465
I.R.C. § 332	258, 405, 465, 497, 501, 502, 508
I.R.C. § 336	465
I.R.C. § 337	465, 466, 470, 497
I.R.C. § 338(g)	257, 258, 546, 549
I.R.C. § 351	121, 286, 453, 463, 464, 465, 468, 469, 477, 478, 479, 483, 484, 488, 499, 501
I.R.C. § 354	467, 484
I.R.C. § 355	496, 501
I.R.C. § 356	501
I.R.C. § 358	553
I.R.C. § 361	467, 470
I.R.C. § 367	464, 465, 467, 468, 469, 470, 471, 500
I.R.C. § 367(a)	495
I.R.C. § 367(a)(2)	483
I.R.C. § 367(a)(3)	471, 473, 475, 476, 478, 486, 496
I.R.C. § 367(a)(3)(B)	474
I.R.C. § 367(a)(3)(C)	476
I.R.C. § 367(a)(3)(C)(ii)(II)	477
I.R.C. § 367(a)(5)	475, 476
I.R.C. § 367(b)	405, 464, 474, 476, 500, 501, 502, 503, 504, 505, 506
I.R.C. § 367(c)(2)	465
I.R.C. § 367(d)	464, 474, 478
I.R.C. § 367(d)(2)(A)	481
I.R.C. § 367(d)(2)(A)(ii)(II)	480
I.R.C. § 367(e)	464, 470
I.R.C. § 367(e)(1)	497
I.R.C. § 367(e)(2)	470, 476, 497
I.R.C. § 367(f)	469
I.R.C. § 368	465, 467
I.R.C. § 368(a)(1)(A)	475, 508
I.R.C. § 368(a)(1)(B)	483, 505
I.R.C. § 368(a)(1)(C)	475, 486
I.R.C. § 368(a)(1)(D)	485, 502, 505, 506

*TABLE OF INTERNAL REVENUE
CODE SECTIONS*

XXV

I.R.C. § 368(a)(1)(F)	475
I.R.C. § 368(a)(2)(C)	485
I.R.C. § 368(a)(2)(D)	496
I.R.C. § 368(a)(2)(E)	496
I.R.C. § 368(c)	465
I.R.C. § 381	508
I.R.C. § 702(a)(6)	247
I.R.C. § 704	543
I.R.C. § 721	499
I.R.C. § 721(d)	499
I.R.C. §§ 861-863	34
I.R.C. § 861(a)(1)	113, 289
I.R.C. § 861(a)(1)(A)	34
I.R.C. § 861(a)(1)(B)	35
I.R.C. § 861(a)(2)	75, 109
I.R.C. § 861(a)(2)(A)	36
I.R.C. § 861(a)(2)(B)	36, 104
I.R.C. § 861(a)(4)	39, 41
I.R.C. § 861(a)(6)	46, 48
I.R.C. § 861(a)(9)	55, 107, 155
I.R.C. § 861(b)	57
I.R.C. § 862(a)(1)	34
I.R.C. § 862(a)(4)	41
I.R.C. § 863(b)	47, 229, 539
I.R.C. § 863(b)(2)	47
I.R.C. § 863(c)(2)	122
I.R.C. § 863(c)(2)(A)	41
I.R.C. § 863(e)(1)(A)	41
I.R.C. § 864(b)	19, 80, 84
I.R.C. § 864(b)(1)	38
I.R.C. § 864(b)(2)	85
I.R.C. § 864(b)(2)(A)(i)	82
I.R.C. § 864(b)(2)(A)(ii)	82
I.R.C. § 864(b)(2)(B)(i)	82
I.R.C. § 864(b)(2)(C)	82
I.R.C. § 864(c)	19, 85
I.R.C. § 864(c)(2)	20, 21, 86
I.R.C. § 864(c)(3)	47, 48, 86, 88
I.R.C. § 864(c)(4)	33, 47, 233
I.R.C. § 864(c)(4)(A)	87
I.R.C. § 864(c)(4)(B)	89, 90
I.R.C. § 864(c)(4)(B)(i)	87, 233

*TABLE OF INTERNAL REVENUE
CODE SECTIONS*

I.R.C. § 864(c)(4)(B)(ii).....	88
I.R.C. § 864(c)(4)(B)(iii).....	88
I.R.C. § 864(c)(4)(D).....	87, 88
I.R.C. § 864(c)(5)(A).....	89
I.R.C. § 864(c)(5)(B).....	89
I.R.C. § 864(c)(6).....	90, 148
I.R.C. § 864(c)(7).....	91
I.R.C. § 864(d).....	364
I.R.C. § 864(e).....	62
I.R.C. § 864(e)(4).....	63
I.R.C. § 864(e)(5).....	66
I.R.C. § 864(f).....	292
I.R.C. § 864(g).....	72
I.R.C. § 865.....	34, 57
I.R.C. § 865(a).....	51, 52, 76
I.R.C. § 865(b).....	46, 47
I.R.C. § 865(c).....	51
I.R.C. § 865(c)(2).....	52
I.R.C. § 865(d).....	42, 50
I.R.C. § 865(d)(3).....	51
I.R.C. § 865(e).....	53
I.R.C. § 865(e)(1).....	54
I.R.C. § 865(e)(2).....	88, 89
I.R.C. § 865(e)(2)(A).....	47, 54
I.R.C. § 865(e)(2)(B).....	47, 54
I.R.C. § 865(f).....	53, 76
I.R.C. § 865(g).....	51, 57
I.R.C. § 865(h).....	53
I.R.C. § 865(i)(5).....	52
I.R.C. § 865(j).....	75
I.R.C. § 871.....	19, 24, 177, 178
I.R.C. § 871(a).....	19, 22, 33, 35, 36, 56, 79, 80, 91, 92, 93, 105, 109, 112, 113, 114, 116, 151, 176, 198, 247
I.R.C. § 871(a)(1).....	20, 177
I.R.C. § 871(a)(1)(B).....	106
I.R.C. § 871(a)(1)(C).....	94
I.R.C. § 871(a)(1)(D).....	105
I.R.C. § 871(a)(2).....	21, 108
I.R.C. § 871(a)(3).....	107
I.R.C. § 871(b).....	19, 20, 31, 33, 37, 57, 79, 80, 114, 233
I.R.C. § 871(c).....	179
I.R.C. § 871(c)(3).....	97

*TABLE OF INTERNAL REVENUE
CODE SECTIONS*

XXVII

I.R.C. § 871(d)	81, 91, 115
I.R.C. § 871(f)	106
I.R.C. § 871(g)	179
I.R.C. § 871(g)(1)(B)	94
I.R.C. § 871(h)	95
I.R.C. § 871(h)(2)(B)	96
I.R.C. § 871(h)(3)	95, 113
I.R.C. § 871(h)(4)	97
I.R.C. § 871(i)	36, 99
I.R.C. § 871(i)(2)(D)	37, 104
I.R.C. § 871(m)	56, 104, 540
I.R.C. § 873	57
I.R.C. § 874(a)	171
I.R.C. § 875	23, 117, 188
I.R.C. § 875(1)	80, 189, 522
I.R.C. § 877A	29, 30
I.R.C. § 877A(a)	29
I.R.C. § 877A(b)	30
I.R.C. § 877A(g)	30
I.R.C. § 881	22, 27, 33, 43, 44, 56, 79, 80, 91, 95, 97, 100, 101, 108, 113, 125, 157
I.R.C. § 881(a)	92, 109
I.R.C. § 881(a)(3)	94
I.R.C. § 881(c)	95
I.R.C. § 881(d)	36, 99
I.R.C. § 882	21, 22, 23, 27, 31, 57, 79, 100, 108, 111, 113, 122, 498
I.R.C. § 882(c)	61
I.R.C. § 882(d)	81
I.R.C. § 883	123
I.R.C. § 884	22, 498
I.R.C. § 884(b)	110
I.R.C. § 884(c)(2)	111, 113
I.R.C. § 884(e)(3)	37, 110
I.R.C. § 884(e)(3)(A)	113
I.R.C. § 884(f)	34, 35
I.R.C. § 884(f)(1)(A)	112
I.R.C. § 884(f)(1)(B)	113
I.R.C. § 887	123
I.R.C. § 887(a)	122
I.R.C. § 892	124, 126
I.R.C. § 892(a)(1)	125

I.R.C. § 892(a)(2)	125
I.R.C. § 892(a)(3)	126
I.R.C. § 894	525
I.R.C. § 894(a)	131
I.R.C. § 894(c)	138, 141
I.R.C. § 897	20, 92, 116, 117, 118, 120, 197, 199
I.R.C. § 897(a)	117, 120
I.R.C. § 897(c)	45
I.R.C. § 897(c)(2)	118
I.R.C. § 897(c)(3)	120
I.R.C. § 897(c)(4)	119
I.R.C. § 897(c)(5)	119
I.R.C. § 897(d)	121
I.R.C. § 897(e)	121
I.R.C. § 897(g)	117
I.R.C. § 897(h)(2)	120
I.R.C. §§ 901-909	16, 240, 244, 258, 261, 267, 490, 522, 579
I.R.C. § 901(a)	230
I.R.C. § 901(b)	231, 232, 247
I.R.C. § 901(b)(5)	233, 247
I.R.C. § 901(c)	233
I.R.C. § 901(i)	254
I.R.C. § 901(j)	233
I.R.C. § 901(k)	268, 532, 533
I.R.C. § 901(l)	268, 533, 534
I.R.C. § 901(m)	256, 257, 258, 548, 549
I.R.C. § 902	231, 261, 266, 267, 287, 291, 334, 399, 402, 456, 458, 503, 521, 534, 543, 547
I.R.C. § 902(a)	260, 262, 263
I.R.C. § 902(b)(1)	261, 262
I.R.C. § 902(b)(2)	261, 262
I.R.C. § 902(b)(3)	262
I.R.C. § 902(c)(2)	263
I.R.C. § 902(c)(7)	261
I.R.C. § 903	231, 234
I.R.C. § 904	33, 230, 258, 259, 267, 269, 273, 290, 402, 404
I.R.C. § 904(a)	270, 271, 272, 273, 274, 275, 283, 289
I.R.C. § 904(c)	231, 270, 284
I.R.C. § 904(d)	273, 274, 289
I.R.C. § 904(d)(1)(B)	274, 275, 277, 281