Assignments for Tax Sessions of Survey of International Tax

Make sure to pick up not only the textbook, but also the supplement that contains the Code, regulations, OECD treaty and commentary, and updates (being handed out in Room 430).

SESSION ONE

Skim pages 1-4 of the textbook (on which some of the introductory material was based). Read pages 7 through the middle of page 15 of the textbook. In the updates, read those to pages 8-13, and then pages 2A and 2B.
Survey of International Taxation

NYU Spring 2005

INTRODUCTION

I. What You Will Learn:

This course affords a study of the United States taxation of international income – that is, income earned in one country and owned in another. (Unlike many treatments of international income taxation, it also shows the importance of deductions.) The basic materials should provide all you need – excerpts from the Internal Revenue Code, regulations, treaties, cases, etc.

It is a survey in the sense that rather than attempting all-inclusive dissection of the international provisions, it focuses on three objectives:

– To explain tax in terms of the meaning and concepts embodied by ordinary American words. The words include sale, royalty, services and interest, four income classifications whose boundaries overlap. (Examples taken up in the course include the provision of credit through cards and of music through the internet). Those definitions and concepts were developed when wealth was physical and delivered physically. A significant theme of the course is the ability to adapt them to a time when so much wealth – computer programs, entertainment and information – is intangible and delivered electronically. Bill Gates of Microsoft has replaced Andrew Carnegie of U.S. Steel as the richest man in America; and it is said that Rudolph Guiliani didn’t clean up Times Square: the VCR did.

– Next, to identify the factors that distinguishes one classification from another. The risk of a building contractor, for instance, relates to his ability to put together a house rather than to its ultimate value; so he is performing services rather than selling a product. The course of course covers rules; but the emphasis is on understanding them – the reasons for them – rather than on reciting them. Everything is open book, and the same factors are gone over again and again in different contexts. Rules change, but the question of whether a book publisher manufacturers goods or delivers information does not go away.

– Third, and perhaps most important, to show what last year’s mislabeled American Jobs Creation Act has done. The Act affords an almost perfect opportunity for a fresh look at this subject. Its principal effect, although not publicized or realized (except by its beneficiaries), is to transfer an enormous amount of wealth from one set of taxpayers to another. It does so in large part by relaxing the United States taxation of international income. Together with other recent and seemingly unconnected events, it reverses the dominant international tax thinking of the last forty years and makes much of it obsolete.
The 2004 Act does so by making key changes in complex rules that almost no journalists and few members of Congress could explain or even understand. Simply put, the changes gut them; and how and why they do so may constitute the most significant part of this course. The way this will play out is yet to be determined. But if you understand what has happened, you will see why corporations will be doing things in the future.

II. Why This is Good For You

Many people are frightened of tax as the language of incomprehensible gurus speaking in tongues that have resonance only for them. This overlooks first, tax lawyers such as Robert H. Jackson ("The Constitution is not a suicide pact"); Harry Blackmun (writer of Roe v. Wade); Sumner Redstone, the chairman of Viacom; and author of perhaps the most widely consulted treatise in any area, Professor James R. Eustice.

Second, tax is all about money; and money matters – as they say about hanging, it tends to concentrate the mind. Tax will come into so many of your future personal decisions: whether to buy or rent a home, what investments to make, how to save for retirement.

On a professional level, understanding how tax looks at the world will help you analyze a transaction no matter what area of the law you enter. For tax looks not so much at labels as to who gets what, and it forces you to look at where and how that is said. At its best, tax rests on economic logic; and this course focuses not so much on the rules for exports, licenses and investment abroad – which are changed substantially by the 2004 Act – as the reasons behind those rules, where the same arguments rage forever.

Most people think of tax as a struggle between themselves and the government. But that attitude looks shortsightedly only at enforcement.\(^1\) Tax policy, as indicated quite explicitly by the JOBS Act,\(^2\) pits taxpayers and nations against one another. It pits United States companies who export against those whose customers are at home; manufacturers vs. services providers; American investment abroad against American investment here; and the United States against other countries as to whether American tax benefits constitute an unfair trade subsidy. (This course only takes up the tax consequences of a World Trade Organization decision that they do and that the JOBS Act repeals, sort of.)

\(^1\) It is understood that an Executive Order prohibits the Commissioner of Internal Revenue from testifying to Congress that the amount allocated to the IRS by an Administration’s proposed budget is not enough. Even apart from such order, however, a Commissioner appointed by and serving at the will of an Administration would be reluctant to contradict it. The public, to which increased IRS funding means greater scrutiny rather than clearer guidance, does not fret over underfunding. Thus, even though funding for enforcement is perhaps the most productive investment the government can make, chronic underfunding of the I.R.S. persists.

\(^2\) To quote Humphrey Bogart’s line in the movie The Maltese Falcon: The cheaper the hood, the gaudier the patter.
The difference resembles that in gambling. Enforcement pits you against the house, as in blackjack or roulette. Policy resembles the dog track, where pari-mutuel means that (although the house takes a cut), it's you against the other bettors.

III. What You Will Read

Be sure to pick up the textbook (Kingson, *International Taxation*), as well as the supplementary materials. The materials consist of:

- A small part of the United States Internal Revenue Code (the Code);
- Some regulations of the Internal Revenue Service that give more detailed explanation of the statutory language (known as Treasury Regulations, or Regulations);
- The Model Income Tax Convention of the Organization for Economic Cooperation and Development, (the “OECD”), an organization to which the United States, the countries of the EU, and other industrialized nations belong. There is included commentary to the convention;
- Updates to the textbook, which include some legislative history of the 2004 JOBS Act.

At the outset – which reinforces the point that tax law is not some special province – the Internal Revenue Service has nothing whatever to do with the provisions of the Internal Revenue Code. The agency just administers and interprets its provisions, although the names are similar).\(^3\) Every word in the Code is a statute passed by the United States Congress, as to the wisdom of which the Internal Revenue Service is reluctant to comment.

The materials identify the Code as 26 U.S.C. – that is, part 26 of the Code of Federal Statutes. The Code is a federal statute as much as the Clean Air Act or Medicare, although longer and purporting to deal with all human activity.

The Regulations, unlike most other federal regulations, are requested and desired by the people affected. Taxpayers want them so that they can have certainty that their actions will have the anticipated tax results; and even when government proposes a moratorium on the issuance of new regulations by federal agencies, industries and bar groups request an exception for tax regulations. The regulations clarify the Service’s interpretation of statutory language and give specific examples.

Even these cannot be sufficiently detailed without being endless; so the Internal Revenue Service (IRS) issues published rulings on specific facts. Taxpayers with similar facts are entitled to rely on published rulings which the IRS must follow; and both they and IRS agents use them as guidance for what is and is not taxable.

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\(^3\) During the 1996 Presidential campaign, certain members of the Republican Party referred to the Code as the Internal Revenue Service Code. Their Presidential candidate, Senator Bob Dole, a long-time member and chairman of the Senate Finance Committee (which handles tax legislation), promptly and publicly repudiated that misstatement.
A country must craft its tax laws affecting income earned by nonresidents (including foreign corporations) with the idea of preventing the use of tax havens to escape tax on income generated within such country, which is referred to as income from sources within that country. A tax haven is a jurisdiction like the Bahamas or Cayman Islands, which imposes no income tax. A county thus generally legislates by imposing a high tax on all domestic source income paid to nonresidents, lest it escape taxation by being paid to Bahamas or Cayman corporations. The United States does this as to United States source income.

But the same considerations do not apply when United States source income is earned by corporations resident in similar countries. The Netherlands, France, England and Germany impose substantial taxes on their resident corporations. To differentiate between United States taxation of Cayman corporations and, say, Netherlands corporations, the United States and Netherlands will enter into a tax treaty limiting or prohibiting taxation by the United States of United States source income paid to Netherlands companies, and vice versa. Treaties modify the Code, and we read them in conjunction with it.

Finally, there remain the updates. The most important recent ones, of course, involve the JOBS Act. But because of the volume of tax legislation and the undermanned IRS, regulations sometimes lag decades behind. Both the Treasury (which includes the IRS) and practitioners therefore rely on legislative history, which explains the reasoning and intention of new Code provisions. The text contains quite a bit of legislative history, which is intended to be – and is – both introduction and guidance. The updates set forth some legislative history of the JOBS Act, which is too recent to have regulations or rulings.