ERRATA AND UPDATE SHEET

This sheet contains corrections and clarifications. You may choose to make some of these changes directly in the text. For more extensive changes, you might decide to simply write a reminder to check this sheet. If you have other changes to recommend, please e-mail me at elarkins@gsu.edu. Thanks much for using my text.

Page 5, next to last line: Replace “exemption” with “long-term deferral”

Page 6, 6th line from bottom of the example: Insert horizontal lines in both columns where example reads “Foreign levy as deduction”

Page 7, footnote 6: Replace with “If Canada imposes a branch profits tax in the profitable year, Short Sport can claim the foreign tax credit for that levy too. However, as Chapter 11 explains, a recapture provision may prevent Short Sport from claiming the full Canadian income and branch profits tax as a U.S. foreign tax credit.”

Page 8, last sentence of second paragraph: Delete.

Page 14, 1st paragraph: Edit the first few sentences to read “The Code contains other provisions designed to thwart U.S. tax deferrals besides those affecting CFCs. Though not as potent of an antideferral weapon, passive foreign investment company (PFIC) rules nonetheless demand respect and work differently than the CFC approach. Rather than tainted earnings causing constructive dividends, …”

Page 14, 2nd paragraph, after 3rd sentence,: Add sentence “… on a similar export sale. However, Congress scaled back the EIE benefit to 12 and 9 percent in 2005 and 2006, respectively, and repealed the benefit for later years. In contrast to …”

Page 21, 1st paragraph after heading, end of 5th line: Replace “to” with “executing”

Page 21, 2nd partial paragraph after heading: Move to bottom of page (i.e., after last example).

Page 24, footnote 1: Replace with “Treasury Department Model Income Tax Convention (November 15, 2006) [hereafter, U.S. Model Treaty]. Many electronic sources, such as Research Institute of America’s CheckPoint, provide easy access to U.S. tax treaties signed and in force.”

Page 25, last sentence of RESEARCH POINTER: Replace with “The international library of Research Institute of America’s CheckPoint contains these valuable research documents as do several other electronic subscription services.”
Page 30, 1st bullet point: Replace “the year” with “a 12-month period”

Page 31, paragraph after “Planning Pointer”: Replace with “Departing from prior practice but consistent with recent revisions to the OECD Model Treaty, the U.S. Model Treaty contains no separate article dealing with independent personal service income. Instead, it treats income from professional services and similar activities of an independent nature the same as other business profit. Add footnote: “U.S. Model Treaty, articles 3(d) and 7.” Resume text: “As explained later, a host country can tax business profit (including independent personal service income) attributable to a permanent establishment in the host country. Nonetheless, most pre-2006 treaties contain separate articles dealing with independent personal service income and allow a host country to tax this income if attributable to a fixed place of business regularly available in such country.”

Page 31, example at bottom: Replace 1st sentence with “The independent personal service article in the U.S.-Sweden Treaty relies on the “fixed place of business” standard to determine taxability.”

Page 35, 3rd line of example: Replace “$230,000” with “$330,000”

Page 36, just preceding the KEY CASE: Add “Thus, persons are PEs when (1) the selling arrangement involves an agency relationship, (2) the principal exercises substantial control over the agent, and (3) the dependent agent routinely concludes contracts on behalf of the principal.”

Page 37, 3rd sentence of example: Edit to read “If Since Charlie frequently concludes sales for Ujwala, he is a dependent agent, and U.S. PE. Thus, Article 7(1) …”

Page 39, immediately after footnote 38 in text: Add “Nonetheless, some treaties exempt profit from inland transportation that is a continuation of international transportation.”

Page 49, 3rd line of 2nd paragraph: Change “overland” to “over land”

Page 49, 2nd sentence of 2nd paragraph: Edit to read “The United States also includes the portion of the U.S. continental shelf area over which international law grants the United States exclusive rights, but only when …”

Page 49, 2nd footnote: Add to end “Under international law, the United States’ exclusive economic zone (EEZ) extends 200 miles out from U.S. shores.”

Page 55, footnote 13: Add to end “Nonetheless, for foreign tax credit purposes, U.S. corporations cannot treat dividends from foreign corporations as foreign source income to the extent the dividends qualify for a dividend received deduction. Section 245 permits a domestic corporation owning at least ten percent of a foreign corporation to claim a dividend received deduction for the portion of E&P that has”
been taxed previously in the United States as effectively connected income. Thus, the
dividend received deduction prevents double U.S. taxation, but such dividends do not
increase the Section 904 foreign tax credit limit.”

Page 55, add to end of example: “Notwithstanding these calculations, any U.S. corporate
shareholders entitled to a dividend received deduction must treat larger portions of
dividends received as U.S. source income.”

Page 55, add as 4th bullet point just before “Dividend Income” heading: “Creditors do not
treat interest received from a foreign partnership as U.S. source income when: (1) the
foreign partnership primarily engages in foreign business, (2) a U.S. business of the
foreign partnership does not pay the interest, and (3) the foreign partnership does not
deduct the interest it pays against U.S. ECI.” Add new footnote at this point: “IRC
§861(a)(1)(C).” Continue text of 4th bullet point: “So, foreign partnerships where
individual partners reside or corporate partners incorporate in the United States will
not necessarily cause the foreign partnership’s creditors to receive U.S. source
interest.”

Page 56, add to end of example: “As in the prior example, entitlement to a dividend
received deduction further reduces Flea Bag’s foreign source dividend.”

Page 57, second line of footnote 14: Replace “foreign” with “U.S.”

Page 58, beginning at 3rd sentence of partial example at top of page: Edit to read “For
foreign tax credit purposes, U.S. shareholders If U.S. persons own all of Bambinelli’s stock, they treat $18,000 of dividends from 2003 E&P and $10,000 of dividends from
2001 E&P ($40,000 x 25%) as U.S. source income for foreign tax credit purposes and
the remaining $212,000 dividends as foreign source income. For most other purposes
(e.g., determining a foreign person’s U.S. tax liability), the entire $240,000 dividends
are foreign source income. If foreign persons own some of the shares, they treat any
dividends received as foreign source income.”

Page 58, 1st sentence of paragraph between examples: Edit to read “… controlled foreign
corporation, foreign personal holding company, and qualified electing fund regimes.”

Page 58, 1st sentence of 2nd example: Edit to read “Planet International, Ltd. Is a
controlled foreign corporation and a U.S. owned foreign corporation in which U.S.
shareholders own all stock.”

Page 59, last paragraph, beginning with 3rd sentence: Edit to read “When entities or self-
employed individuals render services, classifying fees as U.S. or foreign source
income often depends on the facts and circumstances so that these businesses often
base sourcing on time spent abroad or relative payroll costs. both the time and value
of services. When employees render services, they source salary and wages on a time
basis and fringe benefits on a geographical basis. For instance, a fringe benefit
relating directly to work performed abroad (e.g., overseas housing allowance) would
be entirely foreign source income. For individuals, add new footnote at this point: "Reg. §1.861-4." Then, continue text as follows: Other issues arise when employment contracts may be inconsistent, do not correspond with actual practice or unclear about do not specify the services for which the employer pays compensation."

Page 65, footnote 34: Add to end “This source rule also applies to gain from selling tangible investment assets (e.g., rare coins) and personal-use assets (e.g., pleasure yachts).”

Page 67, 1st line of 1st example: Replace “following” with “below”

Page 67, 2nd bullet point: Replace “at least a” with “less than”

Page 73, end of 5th sentence of last paragraph: Add new footnote “Reg. §1.863-1(b).”

Page 76, 9th line of 1st example: Replace “$450,000” with “$150,000”

Page 79, 1st paragraph: Replace with “International communication income is income derived from the transmission of communications (e.g., television or radio programs) or data (e.g., internet pages) between the United States and a foreign country or U.S. possession. For U.S. persons, the Code treats half of international communication income as U.S. source and half as foreign source income. For foreign persons other than controlled foreign corporations, U.S. law considers all international communication income to be foreign source income if not attributable to a fixed U.S. place of business, and U.S. source income if so attributable. Like U.S. persons, controlled foreign corporations split international communication income evenly between U.S. and foreign source income. Footnote 57 should read "IRC§863(e). As Chapter 12 explains, a controlled foreign corporation is a foreign corporation of which U.S. shareholders own more than 50 percent of voting power or stock value." Footnote 58 should read “Prop. Reg. §1.863-9(b)(2)(ii).” Delete footnote 59.

Page 79, example: Edit to read “Fiber Optic Technocrats (FOT) derives $30 million gross income from international communications, of which $8 million is attributable to a U.S. office. If FOT is a U.S. person or a controlled foreign corporation (CFC), half of the $30 million is U.S. source income and half is foreign source income. Generally, if FOT is a foreign person other than a CFC, $8 million is U.S. source income and $22 million is foreign source income. However, the entire $30 million is U.S. source income if the foreign person engages in a U.S. business and cannot establish that the income’s source is foreign. Also, if FOT is a foreign corporation in which U.S. persons own at least 50 percent or which otherwise qualifies as a controlled foreign corporation, the entire $30 million is U.S. source income.”

Page 80, 1st paragraph: Replace with “The source of income derived from space, ocean, and Antarctic activities (areas over which no nation exercise sole jurisdiction) depends primarily on the person driving the income. Generally, U.S. persons derive U.S. source income from such activities while foreign persons earn foreign source
income. However, proposed regulations treat income of U.S. persons as foreign source income when attributable to functions performed, resources used, or risks assumed abroad. Similarly, foreign persons engaged in U.S. business and CFCs earn U.S. source income to the extent attributable to functions performed, resources used, and risks assumed in the United States. Income from space, ocean, and Antarctic activities do not include transportation, international communication, or natural resource income; that is, if sourcing rules overlap, those relating to transportation, international communication, and natural resource income prevail over those relating to space, ocean, and Antarctica.


Page 80, example: Edit to read “Galactic Links leases equipment for conducting experiments beyond the earth’s atmosphere where the gravitational pull is virtually zero. The company’s leasing income is from U.S. sources if Galactic is a U.S. person and not attributable to foreign functions, resources, or risks. If Galactic is a foreign person, it typically derives the leasing income from foreign sources. However, any such income is from U.S. sources if (1) Galactic engages in a U.S. business or qualifies as a CFC and (2) the income relates to U.S. functions, resources, or risks.”

Page 82: Delete sentences between equation (5.1) and the planning pointer and replace with “The United States taxes U.S. persons on worldwide taxable income. So, “U.S. tax before credit” can be expressed as the product of worldwide taxable income and U.S. tax rates. Then, equation 5.1 simplifies to the product of foreign source taxable income and U.S. tax rates. Thus, apportioning deductions to foreign source income reduces the foreign tax credit limit, while apportioning deductions to U.S. source income does not.”

Page 84, 1st sentence of paragraph preceding example: Edit to read “After allocating deductions to gross income classes between statutory and residual groups, taxpayers apportion such deductions between statutory and residual groups on a factual relationship basis.”

Page 87, end of 1st sentence under “U.S. Persons” subheading: Add new footnote reading “However, for taxable years starting after 2008, U.S. corporations can elect under Section 864(f) to allocate and apportion interest expense of their worldwide affiliated group on the basis of the group’s worldwide assets.”

Page 91, beginning with the 2nd sentence after compliance pointer: Edit to read “Under this one-taxpayer rule, affiliated companies allocate and apportion only interest deductions paid to nonaffiliates; they do not treat interaffiliate stock holdings and debt obligations as asset. This provision prevents an affiliated group from establishing a domestic subsidiary …”

Page 93, top of page: Add new paragraph reading “Beginning in 2008, the common U.S. parent of domestic affiliates can elect to allocate and apportion interest expense of the
parent’s worldwide affiliated group based on the group’s worldwide assets (i.e., as though one corporation). The statute allows the election only for the first taxable year starting after 2008 in which a worldwide affiliated group exists (consisting of domestic affiliates and certain controlled foreign corporations). This provision permits U.S. multinationals to elect out of the current rules, which often require apportionment of some interest deductions to foreign source income, even when foreign operations borrow in their own capacities and carry their own debt. To the extent the election reduces a U.S. multinational’s interest apportionment to foreign source income, the foreign tax credit may increase, and the cost of capital may decline.”

Page 93, top of page: Add new paragraph reading “Beginning in 2008, the common U.S. parent of domestic affiliates can elect to allocate and apportion interest expense on a worldwide basis. If elected, domestic members of the worldwide affiliated group determine the interest expense apportioned to foreign source income as follows:

\[ I_f = \left( I_w \times \frac{A_f}{A_w} \right) - I_{fc} \]

where \( I_f \) = interest apportioned to foreign source income,
\( I_w \) = interest expense of worldwide affiliated group,
\( A_f \) = foreign assets of worldwide affiliated group,
\( A_w \) = worldwide assets of worldwide affiliated group, and
\( I_{fc} \) = interest expense of foreign corporations in worldwide affiliated group.

The statute allows the election only for the first taxable year starting after 2008 in which a worldwide affiliated group exists (consisting of domestic affiliates and certain controlled foreign corporations). This provision permits U.S. multinationals to elect out of the current rules, which often require apportionment of some interest deductions to foreign source income, even when foreign operations borrow in their own capacities and carry their own debt. To the extent the election reduces a U.S. multinational’s interest apportionment to foreign source income, the foreign tax credit may increase, and the cost of capital may decline.” Add footnote that reads “IRC §861(f)(1).”

Pages 96 and 97, 3rd sentence of example: Replace “$3 million” with “$2.9 million” and replace “$400,000” with “$700,000”

Page 115, beginning with 1st sentence after bullet point list: Edit to read “The Alternative testing periods begin on the first day of the earliest a 31-consecutive-day period and end on December 31 of the election year. The residency starting date is the first day of the earliest testing period meeting the 75 percent requirement. In testing …”

Page 117, example: Edit to read “Pablo, a Panamanian national and lifelong resident, owns common stock in Home Depot a patent and receives a $10,000 dividend royalty on March 22, 2003 from its use in the United States. As a territorial country, Panama
does not tax the U.S. source royalty dividend.25 Pablo and his wife (a U.S. citizen) move to the United States on April 15, 2003, where he expects to work for the next two years. During this time, he will not travel abroad. So, he files as a dual status alien unless he makes the new resident election. As a dual status alien, he receives the $10,000 royalty dividend as a nonresident alien (i.e., before the April 15 residency starting date). The United States imposes a $3,000 withholding tax ($10,000 x 30%). However, if Pablo and his wife (a U.S. citizen) make the new resident election instead, they receive the $10,000 dividend royalty as U.S. residents. Assuming Pablo pays $500 investment expenses allocable to the dividends, and his marginal U.S. tax rate when filing jointly is 15 percent, his U.S. income tax on the royalty dividend income falls to $1,425 [($10,000 - $500) x 15%].”

Page 120, end of 1st sentence following example: Add new footnote that reads “Section 881(b) grants reduced withholding rates of zero or ten percent when certain foreign corporations organized in U.S. possessions receive U.S. source dividends. The lower rate establishes some parity with corporations organized in foreign countries with U.S. income tax treaties that reduce or eliminate the withholding tax rate on U.S. source dividends. Thus, the reduced rates mitigate the economic disadvantage of buying U.S. corporate shares in the case of foreign corporations created in U.S. possessions vis-à-vis foreign corporations organized in treaty countries.”

Page 120, footnote 3: Edit to read “… and big-6 wheel. Also, Section 872(b)(5) excludes income from pari-mutuel bets placed outside the United States on live horse or dog races in the United States. This exclusion exists because U.S. collection of the tax due is not administratively feasible.”

Page 121, end of footnote 4: Add “Under Section 865(c) and (d), a nonresident alien’s U.S. source income (if any) from a noncontingent sale of a copyright depends on apportionment of prior amortization deductions and whether the nonresident alien has a U.S. tax home.”

Page 122: Add a new footnote to the text just preceding equation 7.1 to read: “No foreign income tax results if the foreign home country uses a territorial system or the effective foreign income tax rate does not exceed the MTR that equation 7.1 yields. Equation 7.1 understates the MTR for foreign countries with global systems and higher effective tax rates.”

Page 126: Add footnote to end of 2nd full sentence to read “Further, the U.S. estate tax does not apply to debt instruments yielding exempt portfolio interest. IRC §§2104(c), 2105(b).”

Page 127: Add new paragraph following example: “Dividends foreign persons receive from most foreign corporations involve no U.S. tax issues. However, when foreign corporations paid U.S. source dividends, the U.S. branch profits tax did not ensue (a topic Chapter 10 covers), and no treaty exemption existed, a U.S. withholding tax applied to foreign recipients. Since the withholding tax applied only in limited
situations and some foreign corporations neglected to withhold anyway, Congress
decided to exempt post-2004 dividends from U.S. withholding tax. So, foreign
corporations paying U.S. source dividends to foreign shareholders no longer must
withhold U.S. taxes, and the Code exempts foreign shareholders from such tax.” Add
footnote: “IRC §871(i)(2)(D), §881(d).”

Page 127: Add new Flashback immediately following the new paragraph above: “As
Chapter 4 explains, U.S. tax law treats most dividends from foreign corporations as
foreign source income. However, a look-through rule converts some distributions
from foreign corporations into U.S. source dividends. Specifically, foreign
corporations treat a pro rata portion of dividends from foreign corporations deriving
at least 25 percent of gross income from U.S. business activities as U.S. source
dividends.”

Page 132, 2nd example: Edit to read “Global Management, Inc. has excess interest
expense of $68,000. Global pays its Canadian parent company $900,000 $90,000
interest, on which Global withholds $90,000 $9,000. Thus, its the parent’s related
person exempt interest income is $60,000 ($90,000 x 20%/30%). Assuming Global’s
debt-to-equity ration exceeds 1.5 to 1, U.S. law disallows a deduction for $60,000 of
Global’s $90,000 interest expense (lesser of $68,000 or $60,000).”

Page 133, example: Edit to read “Tamara, a Nigerian citizen and resident, earns $50,00
U.S. business profit and $20,000 U.S. source dividends royalties from nonbusiness
investments licenses. She apportions $15,000 expenses to the business profit and
$1,000 expenses to the dividends royalties. The Code taxes her $35,000 ($50,000 -
$15,000) net business profit at the normal rates applicable to U.S. individuals and her
$20,000 gross dividends royalties at 30 percent.”

Page 136, footnote 5: Add to end “As this chapter explains later, the pre-1967 force of
attraction principle would have taxed all the Panamanian corporation’s U.S. source
income at regular U.S. rates (and, importantly, allowed deductions against such
income) if a U.S. trade or business had existed.”

Page 139, last sentence of footnote 18: Edit to read “However, the DRD reduces or
eliminates instances in which U.S. taxes apply twice to the same income; the foreign
tax credit reduces or eliminates instances in which U.S. tax and foreign tax apply to
the same income.”

Page 147, footnote 40: Add to end “Section1352 allows electing companies to pay a
tonnage tax on qualified shipping activities in lieu of the corporate income tax.”

Page 148, footnote 44: Add to end “For an excellent example of the cataclysmic results
when a foreign corporation wrongly assumes it does not engage in a U.S. trade or
business, see InverWorld v. Comm., 71 TCM 3231 (1996).”

Page 148, compliance pointer: Add to end “Foreign persons sometimes file protective
returns in the United States showing no gross income and no tax, even when they presumably do not conduct U.S. business activities. If determined later to have engaged in U.S. business and earned ECI, the protective return can preserve deductions and credits.” Add new footnote to end of this sentence: “Reg. §§1.874-1(b), 1.882-4(a).”

Page 150, 2nd sentence of 2nd paragraph: Replace “183” with “182”

Page 173, end of 1st paragraph after Flashback: Add new footnote “Partly because of this enforcement issue and partly because the BPT and U.S. treaties precluded application of the second-level withholding tax in many cases, Sections 871(i)(2)(D) and 881(d) repeal the withholding requirement for post-2004 dividends.”

Page 177, equation 10.1: Replace “1us” with “tus”

Page 186, footnote 8: Edit to read “Under IRC § Section 172(b)(1)(A), taxpayers can carry net operating losses back two 2 and forward 20 years. In contrast, IRC § Section 904(c) allows taxpayers to carry an unused FTC back 2 one and forward 5 ten years. Legislative bills have proposed increasing the FTC carryforward period.”

Page 188, 1st full paragraph, beginning with 5th sentence: Edit to read “However, such taxpayers can elect to use the exchange rate applicable to the day they pay foreign income tax if the foreign country requires payment in a denomination differing from the taxpayer’s functional currency. Also, accrual basis taxpayers …”

Page 188, footnote 15: Add to end “In addition to these two criteria, Compaq Computer Corp. v. Comm., 113 TC 214 (1999), warns taxpayers not to enter simultaneous buy-sell transactions otherwise generating creditable taxes if they lack market risk and, thus, business purpose. Though the fifth circuit reversed the Tax Court in 2001 (277 F.3d 778), taxpayers still should heed the lower court’s warning and eschew transactions lacking economic substance.

Page 209, footnote 59: Edit to read: “IRC §902(b)(1). Further, Section 902(c)(7) clarifies that a partnership interposed between a U.S. parent company and its foreign subsidiary does not preclude a DPC. Instead, the statute treats the foreign subsidiary’s stock the partnership owns as though the partners (including the U.S. parent company) directly own such stock in proportion to their partnership interests.”

Page 212, footnote 63: As the 3rd sentence of the footnote, add “In effect, the limitation for taxpayers with foreign income but U.S. losses equals worldwide taxable income times the applicable U.S. tax rate.”

Page 216, first two sentences: Edit to read “The FTC for AMT purposes equals the lesser of creditable taxes and the AMT limitation, per equation 11.7, subject to one additional restriction. The allowable FTC cannot exceed 90 percent of the taxpayer’s tentative minimum tax before the FTC.”
Page 216, paragraph following equations, starting with 2nd sentence: Edit to read “…
Taxpayer carry excess credits back to the **two** preceding taxable years and treat them as creditable taxes in **those** that years. If an excess limits exists in the prior years (before considering the carryback), taxpayers claim the excess credits they carry back as FTCs in **those** that earlier years, resulting in a tax refund. When taxpayers cannot claim refunds for all excess credits due to an insufficient excess limits in the **two** previous years, they carry remaining excess credits forward as creditable taxes to the next **five** ten taxable years." 69

Page 216, 2nd sentence of last paragraph before example: Change “fifth” to “tenth.”

Page 216, footnote 69: Edit to read “IRC §904(c). Prior to the American Jobs Creation Act of 2004, FTCs could be carried back two and forward five years.”

Pages 216-17, example: Edit to read: “Optical Illusion, Inc., a U.S. corporation, has $130,000 creditable taxes in 2005. Its 2005 limitation, using equation 11.4, equals $80,000. Thus, the company has a $50,000 excess credit in 2005. Optical’s FTC positions for the twelve-year window applicable to 2005 (before considering carryovers) are:

<table>
<thead>
<tr>
<th>Year</th>
<th>Excess Credits</th>
<th>Excess Limits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td></td>
<td>$35,000</td>
</tr>
<tr>
<td>2005</td>
<td>$50,000</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>15,000</td>
<td></td>
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<tr>
<td>2009</td>
<td>2,000</td>
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<tr>
<td>2010</td>
<td>3,000</td>
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<td>2011</td>
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<td>2013</td>
<td>8,000</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td>12,000</td>
</tr>
</tbody>
</table>

“Optical first carries its $50,000 excess credit back to 2004, resulting in a $35,000 tax refund. The remaining $15,000 excess credit carries forward to 2015 (the next year with an excess limit) and reduces 2015 income tax by $12,000. The remaining $3,000 excess credit from 2005 expires unused; U.S. law does not permit Optical to deduct the $3,000.”

Page 217, end of footnote 72: Add “For example, U.S. law sources income from services according to where the taxpayer renders them. Thus, a U.S. parent company that performs U.S. services for its foreign subsidiary treats the management fee as U.S. source income. Any foreign withholding tax on the fee may result in double tax since creditable taxes increase without a corresponding boost to the limitation formula.”
Pages 218-19, example: Edit the last sentence to read: Assuming profit levels and tax rates remain constant, ….”

Page 219, paragraph between examples: Edit to read “To the extent excess credits do not exist, low-taxed foreign profits result in a **residual U.S. tax.**

Page 220, example ending on this page: Add to the end “This outcome assumes Rap has no excess credits from high-tax foreign activities (as in the prior example).”

Pages 220-221, example beginning on this page: Don’t alter introductory paragraph, but change the columned presentation as follows—

<table>
<thead>
<tr>
<th>Combined</th>
<th>Belgium</th>
<th>Taiwan</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$10,000,000</td>
<td>$1,000,000</td>
<td>$11,000,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>a. Taxable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>x .40</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>b. Applicable tax rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>x .25</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>c. Income tax (before FTC in U.S.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$4,000,000</td>
</tr>
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</table>

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<tr>
<th>d. FTC limit (equation 11.6)</th>
</tr>
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<tbody>
<tr>
<td>$3,740,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>e. FTC (lesser of lines c and d, column 3)</th>
</tr>
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<tbody>
<tr>
<td>$3,740,000</td>
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</tbody>
</table>

<table>
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<tr>
<th>f. U.S. income tax</th>
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<tbody>
<tr>
<td>$ 0</td>
</tr>
</tbody>
</table>

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<tr>
<th>g. Excess credit (equation 11.8)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 510,000</td>
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</table>

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<tr>
<th>h. Decrease in U.S. tax (from prior example)</th>
</tr>
</thead>
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<tr>
<td>$ 90,000</td>
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<thead>
<tr>
<th>i. U.S. tax refund from one-year carryback</th>
</tr>
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<tbody>
<tr>
<td>90,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>j. Increase in worldwide tax (line c, column 1, less lines h and i)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,820,000</td>
</tr>
</tbody>
</table>

Replace the last paragraph in this example with the following: “**Without the existing operations in Taiwan, Rap’s new investment in Belgium would have increased its worldwide tax by $4 million. But given the existing Taiwanese investment, Rap might find the new investment in Belgium to be more attractive since it decreases current U.S. tax by $90,000 and also generates a $90,000 tax refund. Thus, the excess limit from existing Taiwanese activities creates an incentive to conduct business in Belgium, a high-tax jurisdiction. Assuming profit levels and tax rates remain constant, future excess limits in Taiwan will continue to absorb $90,000 of excess credits Rap expects from Belgian operations.**”

Page 225, just preceding the last paragraph: Replace “**U.S. residual!**” with “**dividend withholding**”
Page 226, last paragraph: Edit to read “Unlike some countries, the United States does not require taxpayers to place income earned in different countries into separate baskets. Instead, U.S. law specifies separate baskets for eight types of foreign source income. Three baskets contain passive-type income, two baskets pertain to income from specific industries, and three baskets relate to export profits. Income not allocable to one of these baskets falls into the residual basket. For taxable years beginning after 2006, six baskets will disappear, requiring taxpayers to segregate their income between only two baskets: one for passive and one for residual income. The two-basket system will greatly increase cross-crediting opportunities for many U.S. multinationals. Unlike some countries, the United States does not require taxpayers to place income earned in different countries into separate baskets. The following listing briefly describes the eight baskets applying until 2007:”

Page 227: Delete the last bullet point and footnote 83.

Page 228, last sentence of 2nd bullet point: Replace “Lebanon” with “Liberia”


Page 233: Add new footnote to end of 2nd sentence that reads “As Chapter 17 explains, Section 367(d) may tax certain outbound transfers of intangible assets in situations where a similar domestic transfer of the same asset would avoid current U.S. tax. In these situations, Section 367(d)(2)(C) treats amounts received for the intangible assets as royalty income rather than gain from sale. Thus, the look-through rule applies to such royalties, often resulting in a substantial allocation to the residual basket. In contrast, if U.S. law had treated amounts received as gain from sale, the entire amount would fall into the passive income basket, a less favorable outcome in many cases.”

Page 233: Add as a new paragraph just after example “A similar look-through rule applies to dividends a U.S. parent company receives from a foreign corporation in which the parent owns at least 10 percent of the voting power but no more than 50 percent of either the voting power or stock value. Such foreign corporations are known as noncontrolled section 902 corporations (or 10-50 companies). In contrast to CFCs, the look-through rule applicable to 10-50 companies applies only to dividends, not to other remittances such as interest and royalties.” [Add new footnote here, which reads: “IRC §904(d)(4)(A). For taxable years beginning before 2003, U.S. law placed dividends from each 10-50 company into a separate basket. Thus, a U.S. corporation owning seven 10-50 companies placed the dividends from these
companies in seven separate baskets. Not only did this rule entail significant record-keeping burdens for U.S. multinationals, but the lack of cross-crediting opportunities discouraged many companies from seeking or holding minority positions in foreign joint ventures.”]

Page 235, footnote 95: Edit to read “IRC §904(f)(5)(B). When the United States moves to a two-basket FTC system in 2007, taxpayers must allocate losses in one basket against income in the other basket.”

Page 241, 4th line of 1st footnote: Replace “2003” with “2008”

Page 241, next to last line of 1st footnote: Edit last sentence to read “However, qualified foreign corporations do not include foreign personal holding companies and passive foreign investment companies, entities discussed in Chapter 13.”

Page 241, bottom half of 1st paragraph: Edit to read “Third, U.S. stockholders report gross income for constructive dividends they receive from foreign personal holding companies, qualified electing funds, and controlled foreign corporations (CFCs). This chapter defines CFCs and explains when a CFC’s U.S. shareholders recognize constructive dividends.² Chapter 13 covers foreign personal holding companies and qualified electing funds.”

Page 243, end of 3rd paragraph: Add the following footnote: “As a one-time incentive to remit foreign earnings and stimulate the U.S. economy, Section 965 grants a temporary 85 percent dividend received deduction to electing corporate U.S. shareholders receiving cash dividends from CFCs. Several limitations apply to this deduction. First, qualifying dividends cannot exceed the greater of $500 million or the amount permanently held abroad per financial statements. Second, only extraordinary dividends qualify (i.e., those exceeding average dividends in three of the past five years, ignoring the years with the highest and lowest dividends). Third, repatriated funds must be reinvested under a company-approved domestic reinvestment plan and flow into specified U.S. activities expected to benefit the U.S. economy (e.g., job creation or training, research and development, or capital investments). Fourth, any increase in the CFC’s related person debt reduces dividends that otherwise might qualify (to curtail remittance of recently-borrowed funds). Fifth, dividends qualify only if received during the U.S. corporation’s last taxable year beginning before October 22, 2004, or first taxable year beginning during the one-year period starting October 22, 2004. U.S. corporations making this election cannot obtain double tax benefits related to remitted profits such as dividend received deductions under pre-existing statutes, foreign tax credits, or deductions apportioned to qualifying dividends. Also, electing U.S. corporations cannot use net operating losses to offset the 15 percent nondeductible portion of qualifying dividends, and any U.S. tax resulting from the nondeductible portion cannot reduce the corporation’s alternative minimum tax. Thus, taxpayers should carefully weigh the overall impact of this one-time deduction before making an election.”
Page 243, 4th paragraph: Edit to read “The IRS has two several antideferral weapons at its disposal to prevent unintended benefits from tax deferral such as those just mentioned. The next chapter examines two regimes a regime that often thwarts deferral strategies: passive foreign investment companies and foreign personal holding companies. However, the most potent …”

Page 254, top of page: Delete Planning Pointer at top of page and replace with following two regular paragraphs: “In corporate inversions (or corporate expatriations) occurring before March 24, 2003, U.S. publicly traded companies restructuring as foreign corporations usually avoided the CFC regime. Widely held shares prevented foreign corporations from having U.S. shareholders (under 10 percent ownership definition) or, at least, U.S. shareholders from aggregately holding sufficient shares for CFC status (under 50 percent test). After reorganizing in low-tax foreign jurisdictions, inverted corporations could defer U.S. residual tax, dramatically reducing the marginal tax rate. Though Subchapter C provided multiple paths to an inverted solution, the exchange of shares and transfer of assets could have resulted in taxable transactions at both shareholder and corporate levels. However, the financial markets in the late 1990s increased the popularity, if not the public’s approbation, of inversions. As stock prices nose-dived, shareholders did not mind exchanging shares in former domestic corporations for equity interests in essentially identical foreign corporations since the resulting exchange losses did not increase U.S. taxes. Similarly, U.S. corporations often possessed net operating losses and other tax attributes to offset additional U.S. taxes from transferring assets to foreign corporations.

“The American Jobs Creation Act of 2004 seriously curtailed such tax planning in two situations. First, the Code treats new foreign parents as U.S. corporations (effectively denying deferral) when:

• U.S. owners of an expatriated entity (i.e., U.S. corporation or partnership) acquire at least 80 percent of a foreign corporation,
• The foreign corporation acquires substantially all properties of the expatriated entity, and
• The expanded affiliated group does not have substantial business activities in the foreign host country. [Add footnote: IRC §7874(b).]

Second, when the expatriated entity’s U.S. owners acquire at least 60 percent but not 80 percent of the foreign corporation (modification of the first standard above) and meets the other two criteria, U.S. law respects the foreign nature of the surrogate foreign corporation. However, inverted entities cannot use net operating losses, foreign tax credits, or similar attributes to offset recognized gain from stock or asset transfers implementing the corporate inversion. [Add footnote: IRC §7874(a)(1), (e)(1). As a further disincentive to invert, Section 4985 imposes a 15 percent excise tax (20 percent after 2008) on the fair market value of insiders’ stock-based compensation, such as options, if an expatriated corporation’s shareholders otherwise recognize inversion-related gain.]”
Page 254, 2nd sentence before “Planning Pointer” at bottom of page: Delete “FBC shipping income,” from sentence.


Page 271, footnote 66: Edit to read “IRC §954(c)(1). FPHCI does not include export financing interest. Also, Section 954(c)(4)(A) allows CFCs owning 25 percent or more of a partnership to treat the gain resulting from selling an interest in the partnership as gain from selling the underlying assets. Under this look-through rule, CFCs will not treat the entire gain as FPHCI but only the portion of gain attributable to FPHCI resulting from an asset-by-asset analysis at the partnership level. This provision greatly simplifies the sale of partnership interests, decreasing the tax motivation of CFCs to structure such transactions as asset sales.”

Page 272, 1st paragraph following example: Delete entire paragraph including footnotes 70 and 71.

Page 278, next to last bullet point: Edit to read “Obligations of noncorporate U.S. persons, except U.S. government instruments, currency, bank deposits, debt instruments of unrelated persons (under 25 percent test similar to one in preceding bullet point), dealer securities held for sale to customers in the ordinary course of business, and accounts receivables from selling or processing property.96” Also, expand footnote 96 to read “IRC §956(c)(1)((C), (2)(A), (C), (L), (M). However, …”

Page 279, last paragraph of example: Edit to read “Piratical’s investment in U.S. property equals $120,000 $130,000 ($20,000 + $70,000 + $30,000 + $10,000). If Piratical’s applicable earnings equal $115,000 $125,000, the U.S. parent company realizes a $115,000 $125,000 constructive dividend.”

Pages 301-308: Eliminate the entire section entitled “Foreign Personal Holding Companies”

Page 310, end of 1st full paragraph: Edit to read “Following a second round of EU protests, a WTO panel found the EIE to be illegal also, and an appellate body affirmed the holding in 2002. This latest WTO decision may prompted Congress to repeal the EIE, but repeal is not certain. Until Congress decides how to respond to the latest WTO ruling, the EIE continues to be the law of the land, bestowing significant tax benefits on U.S. exporters, subject to two transitional rules. For 2005 (2006), exporters qualify for only 80 percent (60 percent) of the EIE to which they would have been entitled under pre-2005 law. The second transitional rule preserves the EIE for export sales occurring under binding contracts entered into before September 18, 2003, with unrelated persons. [Add new footnote here: Coupled with the EIE repeal, though not a distinctly international provision, Congress added a new deduction for production activities occurring in the United States. The deduction equals a percentage of whichever is less, taxable income or qualified production activities income, but cannot exceed half of the taxpayer’s W-2 wages. The percentage starts at
three percent in 2005 and 2006 and increases over five years to its nine percent maximum. See IRC §199."

Page 310, Planning Pointer, 1st sentence: Edit to read “The EIE provides a permanent tax exemption of 15 to 30 percent (but, except in the case of binding contracts, 12 to 24 percent in 2005, 9 to 18 percent in 2006, and zero after 2006). In contrast, …”

Page 311, sentence preceding Planning Pointer: Edit to read “… is better than the EIE’s pre-2005 15 to 30 percent exemption …”

Page 311, last partial paragraph, starting with 1st sentence: Edit to read “The EIE provides a pre-2005 tax exemption ranging from 15 to 30 percent of export profit. For net export profit margins of 8 percent or higher (4 percent or lower), the pre-2005 EIE benefit equals 15 percent (30 percent). Profit margins between 4 and 8 percent result in pre-2005 tax savings between 15 and 30 percent. Thus, the marginal tax rates applicable to export profits depend on profit margin levels and range between 70 and 85 percent of the U.S. tax rate applicable to domestic sales.”

Page 312, Example: Edit to read: “… Since export sales with profit margins of 14 percent yield a pre-2005 15 percent EIE benefit, the marginal tax rate on export sales equals 28.9 percent (34% x 85%) assuming 2004 export sales, 29.92 percent (34% x 1 - 15%) assuming 2005 export sales, 30.94 percent (34% x 1 - 60% of 15%) assuming 2006, and 34% assuming years after 2006 (unless the binding contract transitional rule applies). Thus, Assuming 2004 export sales, the U.S. tax liability on the $6 million of worldwide profit is $1,989,000 (34% of $5 million + 28.9% of $1 million), a tax savings of $51,000. If the export sales occur in 2005, the U.S. tax liability increases to $1,999,200 (34% of $5 million + 29.92% of $1 million), yielding tax benefits of $40,800. Similarly, assuming the sales occur in 2006, the U.S. tax liability and tax savings are $2,009,400 and $30,600, respectively.”

Page 346, 1st sentence: Edit to read “U.S. individuals residing in the U.S. Virgin Islands (USVI) on the last day of the during the entire taxable year, …”

Page 361: Delete two sentences appearing after the judicial cite in footnote 34.