Answer-to-Question- 1

Part 1

Since Marie is a citizen and resident of France (and not US) her status is that of an alien individual. For an alien individual to be considered as a Resident in US with respect to any calendar year, **either** of the following three conditions is fulfilled:-

(i) Such individual is lawful permanent resident of the United States (Lawful admission for permanent residence test); **OR**

(ii) Such individual meets the substantial presence test (requirement to be present in a particular calendar year for at least 31 days and the sum of days on which he was present in the United States during the current year and 2 preceding years exceed a prescribed threshold); **OR**

(iii) Such individual makes the election in accordance with the rules given in the relevance provisions.

Applying the above principles to the situation of Marie relating to the calendar year 2014, the only condition which appears to be examined in Marie's case is condition number (ii) viz. Substantial presence test.

Under this test, both the following conditions (subject to certain exceptions) are required to be fulfilled by an alien individual to be considered as US resident:-

(a) such individual was present in the United States on at least 31 days during the calendar year; **AND**

(b the sum of the number of days on which such individual was present in the United States during the current year and 2 preceding calendar years equals or exceeds 183 days (when multiplied by the applicable multiplier).

As per information available, Marie has been in US for calendar year 2014 for the first time and it appears that she was not present in US for last two calendar years. As her stay in US for 2014 was less than 183 days, she will be considered as 'non-resident alien individual' for the purposes of calendar year 2014.

Being a non-resident alien individual, Marie is only subject to US taxation for her income derived from sources within the United States. In the context of her Salary income, the source rules relating to personal services are relevant whereby compensation for labour or personal services performed in United States is considered to be US sourced. There is an exception for di-minimum rule which inter alia makes such source rule inapplicable if the remuneration was not above USD 3,000 and the stay of alien individual remained less than 90 days. This not being the case here, Marie is liable to US taxation to the extent of her salary attributed to the number of days she stayed in US during the calendar year 2014.

Since her annual salary is stated to be USD 1 Million, it would be reasonable to attribute her salary income on the basis of 150 days divided by total number of days in a year. The proportionate salary income relating to her stayed days in US will be considered as US sourced and hence taxable in USA.

Part 2

In case of a Double Tax Treaty executed on the pattern of 2006 US Model Double Tax Conventions, Article 14 is the relevant Article which deals with the determination of source rules (and thus the extent of taxation rights which US can exercise over such income) of Income from employment.

Under the said Article, salaries, wages and other similar remuneration derived by a resident of a Contracting State (viz. France in the instant case), in respect of an employment is only taxable in France unless the employment is exercised in the other Contracting State (i.e USA). If the employment is so exercised, such remuneration as is derived therefrom can be taxed in the source state (i.e. USA).

There is, however, an exception to the above Rule whereby remuneration derived by a resident of France in respect of an employment exercised in USA shall be taxable only in France (and thus exempt in USA) if:

(a) the recipient is present in USA for a period or periods not exceeding in aggregate 183 days for all 12 months period commencing or ending in the taxable year concerned;

(b) the remuneration is paid by or on behalf of an employer who is not a resident of USA; and

(c) the remuneration is not borne by a permanent establishment that the employer has in USA.

In the instant case, since all three conditions are satisfied (as Marie's presence is less than 183 days and her employer Eversharp Tools is not a resident of USA nor maintains any Permanent Establishment in USA), Marie will not be taxable in US with regard to her salary income relating to employment exercised in USA. In other words, her entire salary income for calendar year 2014 will only be taxed in France.

Part 3

As regards 2015, the residential status of Marie will again has to be determined in accordance with the **Substantial Presence test** embodied in the relevant IRC Code. As per the said test, an individual can be considered as resident in US, if following conditions are met:-

(a) Stay in US for a particular calendar year remains at least 31 days; **AND**

(b) sum of the number of days on which such individual was present in the United States during the current year and the 2 preceding years equals or exceeds 183 days.

In the instant case, Marie has fulfilled both the conditions as her stay in 2015 is more than 31 days and sum of the number of days on which she was present in United States during 2015 and 2014 exceeds 183 days (as per applicable rule, the number of days for first preceding year are required to be taken as 1/3rd which comes to 50 whereas her current year's stay is already 160 days. The aggregate of these two numbers come to 210 days).

There is, however, an **exception** to the above rule which applies if the individual fulfills the following two conditions:-

(1) such individual was present in the United States on fewer than 183 days during the

current year; **AND**

(2) it is established the for the current year such individual has tax home in a foreign country and has a closer connection to such foreign country than to the United States. The term tax home in this context is defined as such individual's home.

In the instant case, as Marie's stay in US for 2015 has remained less than 183 days and her family home is in France (whereas her stay in US limited to hotels) she will not be considered as resident in US for calendar year 2015.

Consequent to the above residential status, Marie will remain subject to US taxation only to the extent of her salary attributable to the number of days she has stayed in US for calendar year 2015.

Part 4

Now, looking at the situation in Calendar year 2016, one has to again apply the principles of **substantial presence test** whereby Marie can be considered as resident in US, if following conditions are met:-

(a) Stay in US for a particular calendar year remains at least 31 days; AND

(b) sum of the number of days on which such individual was present in the United States during the current year and the 2 preceding years equals or exceeds 183 days.

In the instant case, Marie has fulfilled both the conditions as her stay in 2016 is more than 31 days and sum of the number of days on which she was present in United States during 2016, 2015 and 2014 exceeds 183 days.

With regard to the exception where the individual was present in the United States during less than one-half of the year and closer connections with a foreign country are established, since Marie's stay in 2016 was more than half of the calendar year, she does not fall within the purview of this exception.

In view of the above, Marie's status for 2016 will be considered that of a resident alien individual.

Part 5

Under Article 4 of the US Model Tax Convention, the term 'resident of a Contracting State' means any person who under the laws of that State is liable to tax therein by reason of the domicile, citizenship, place of management, place of incorporation, or any other criterion of similar nature. The term however does not include a person who is only liable to tax in a particular Contracting State to the extent of income from sources situated in that State.

Under the tie-breaking rule, if an individual is a resident of both the Contracting States, then his status has to be determined as follows:-

a) she is deemed to be a resident only of the Contracting State in which she has a permanent home available to her and even if she has permanent home available in both the States, she is considered to be resident of that state where her centre of vital interests are situated.

b) If permanent abode cannot be determined, the test of habitual abode is applied.

c) If habitual abode is situated in both the States, then nationality test is applied.

In all the above cases, it is evident that if Marie is considered to be resident of both Contracting States (in France because of her domicile or any other criteria requiring her to pay tax on worldwide income and in USA on the basis is substantial presence test), since her permanent home is in France and her centre of vital interests is also situated in France, she will be considered as Resident of France and hence, the taxation of her salary will be still be governed by Article 14 whereby the US will exercise the right to tax her income to the extent of employment exercised in US during that particular year. In other words, her salary will have to be apportioned on the basis of her stay in US as compared with total number of days in that calendar year. The exception provided in Para 2 of Article 14 will not apply as her stay in US in 2016 is more than 183 days.

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Answer-to-Question-2

Part 1

The status of DejaBrew is that of a **domestic corporation** as the same is incorporated under the laws of Delaware**.** In this context, the fact that its shareholders are non-residents of US or foreign persons does not alter the tax residential status of this company.

Being a domestic corporation, Dejabrew is considered as US person which is taxable in US on its world wide income (which includes both income earned from sources within United States and that earned from sources outside United States).

However, with regard to foreign sourced income / income earned from sources outside US, Dejabrew being a US person is allowed to claim a foreign tax credit for any taxes paid in foreign jurisdictions with regard to foreign sourced income. In case of foreign tax credit being lesser than the US tax on the same income, the differential has to be paid to US. In case of foreign tax in excess of US tax on such income, the excess can be carried forward for adjustment against the tax liability of succeeding 10 years and carried back to an immediately preceding year.

There are however certain limitations and computational aspects relating to foreign tax credit, which are largely dependent upon the sourcing of income earned from foreign sources.

In the instant case, since the title in goods has passed within US, the related income is considered to be US sourced and hence no foreign tax credit will be allowed on such income.

In the instant case, the total Federal US tax charge on income derived by Dejabrew will be computed as 35% of 1 Million (which includes both local and foreign sourced income). This tax incidences comes to USD 350,000. Since Dejabrew has paid USD 150,000 as foreign tax on its foreign sales related profit of USD 400,000, ordinarily the US tax on such income will be computed as 35% of USD 400,000 which comes to USD 170,000. However, as the Company opted to have the title transferred within US, it has lost the right to claim foreign tax credit in the absence of any US sourced income.

The above situation could have been avoided if the company had changed the sourcing rules by opting to have the title transferred outside US. In such a case, 50/50 rule applies whereby in case of export of manufactured goods, 50% of the export sales income is considered to be sourced in USA and remaining has to be apportioned on the basis of production assets.

By opting to change the title passage rules, the company would have increased its US sourced income thus entitling the foreign tax credit on such income. Had such credit been in excess of US tax on the same income, the excess can be carried forward to next 10 years with a right to carry back for one year.

Part 2

As FCO1 is not a per se corporation under US tax principles, its default classification for US tax purposes would be that of a foreign branch which will be merely an extension of Dejabrew in the foreign country A. In other words it would be a transparent entity hence all its income derived abroad will be considered as part of the income of Dejabrew. However, as the income is relating to the active conduct of trade or business outside US through a proper office owned by FCO1, the related income earned therefrom should classify as foreign sourced / non-US sourced income and any foreign tax paid thereon will rank as admissible foreign tax credit against the foreign sourced income of the company.

Had the FCO1 incurred any loss, the same could have also been adjusted against the income of Dejabrew in US in accordance with the applicable loss adjustment rules.

Sales made to FCO1 on an arm's length basis but for which title was transferred within US will again be classified as US sourced income and hence not eligible for any foreign tax credit.

Part 3

Royalty received by Dejabrew amounting to USD 200,000 from FCo2 will be classified as foreign sourced royalty as the related property (i.e. manufacturing intangibles) were used outside US. Consequently, the withholding tax suffered on such income at 30% in foreign country will be treated as foreign tax which can be claimed under foreign tax credit mechanism for the US tax applicable on such royalty income.

The status of FCO2 will not be that of a CFC for the purpose of inclusion of Subpart F income as the goods being sold by FCO2 are not merely after purchase and resale mechanism rather the same are actually manufactured and produced in the Country B. As regards the loan issued by Fco2 to Dejabrew, interest thereon has to be computed on an arm's length standard and such interest will be then considered as taxable in USA as the same is borne by a US person (i.e. Dejabrew).

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Answer-to-Question-3

Part 1

JBr's purchase of clothing from USCo and the resale of the same in US gives rise to effective connected income in US. Consequently, the profit earned from such income will be considered as US sourced and hence taxable herein.

Part 2

In determining whether income from sources within the United States of interest is effectively connected with the conduct of a trade or business within the United States, the factors taken into account shall include whether-

(A) the income, gain or loss is derived from assets **used in** or **held for use** in the conduct of a trade or business; or

(B) the activities of such trade or business were a material factor in the realisation of the income, gain or loss.

In view of the above, it appears that only that part of interest income can be considered as effectively connected income which relates to USD 2.5 Million required to be used in JBr business of US.

Part 3

Applying the principles discussed in part 2 above, royalty derived from unrelated parties for their use of the JCo name in relation to their US business activities cannot be considered as part of effectively connected income as the underlying brand name is not used in or held for use in US business rather the same belongs to the Head office which is situated outside US. Further, derivation of such income is not a material factor in the realisation income by JBr.

Part 4

Income from sale of diamond which was not held as inventory by JBr rather the same was held by the JCo head office cannot be considered as effectively connected with US trade or business as there appears to be no material role of JBr. However, because of title passage rule in US, the same can be considered as part of JBr income by way of force of attraction rule applicable under the DTTs.

Part 5

The entire income from sale of goods in Canada will form part of effectively connected income as products were shipped by JBr and their employees participation in the transaction demonstrate the active involvement.

Part 6

The income derived from sale in Mexico is not effectively connected with JBr's business income as the employees merely travelled to assist but did not have any authority to conclude contract on behalf of JCo. As such there was no material participation of JBr in the execution of transaction hence related income was not effectively connected with US trade.

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Answer-to-Question-5

Under Article 22 of US Model Tax Convention, a resident of a Contracting State is not entitled to the benefits of the Convention, unless such resident person is a "qualified person" as defined in Paragraph 2 of the Article at the time when the benefit would be accorded.

Under Para 2 of the aforesaid Article, a resident of a Contracting State is a qualified person at the time when a benefit otherwise would be accorded by this Convention if, at any time on at least half of the days of any 12 month period that includes the date when the benefit otherwise would be accorded. There is a list of persons vis-a-vis criteria in Paragraph 2 which defines qualified person in terms of an Individual, listed company, unlisted company, etc.

As regards the instant case where the Company RUCO is otherwise an eligible entity organised under the laws of Country R, the limitation of benefits clause cannot limit the application of Double Tax Convention because of the following points:-

(a) At least 50% of the shares are held by Individuals who are otherwise resident in Country R and hence entitled to the benefits of US / Country S Double Tax Convention;

(b) less than 50% of the Company's income is paid or accrued directly or indirectly to a Russian Bank which although is not resident in either Country R or US but not a connected person with RUCO.

As regards the individual shareholders, both Henri and Claude being residents of R and not otherwise hit by any Limitation of benefits clause of Article 22 should remain entitled to the benefits of US Model Tax Convention.

With regard to Gerald and Richard, since both of them are not residents of either US or Country R, they are not entitled to the benefits of Double Tax Convention between US and Country R unless their respective DTT between Country S and US provide similar releifs as are otherwise available under Country R and US Double Tax Treaty.

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Answer-to-Question-4

In order to be classified as United States real Property Holding Company, it is essential that the value of immovable property held by such company (directly or indirectly) comprise of 50% of above in the total fair market value of the assets held by such company.

In the above context, if we examine the assets composition of NATCO, the fair market value of US real property held directly (USD 4 Million) as well as that held indirectly (USD 5 Million) together does not constitute more than 50% of total fair market value of all asset (including cash in hand)hence the status of NATCO is not that of a US Real Property Holding Corporation.

As regards PCo, since the fair market value of US Real property held by it is exactly 50% of total assets fair market value, its status should be regarded as that of a US Real Property Holding Company.

In terms of Article 13 of US Model Tax convention the gain on disposal of PCo can be considered as taxable in USA as the same would be treated as an indirect sale of underlying US property.