UPDATES AND OTHER TIDBITS

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Tags
Corporate Tax
Partnership Tax
Foreign Tax Credit

SUPPORT FOR PROPOSED BILLS LIMITING CORPORATE INVERSIONS WEAK GIVEN DESIRE FOR FULL INTERNATIONAL TAX OVERHAUL

The Stop Corporate Inversions Act was introduced in the Senate on May 20 by Senator Carl Levin. The bill represents an attempt to tighten U.S. tax rules preventing so-called “inversion” transactions, defined generally as those involving mergers with an offshore counterpart. Under current law, a U.S. company can move its headquarters abroad (even though management and operations remain in the U.S.) and take advantage of lower taxes, as long as at least 20% of its shares are held by the foreign company's shareholders after the merger. Under the bill, the foreign stock ownership for a non-taxable entity would increase to 50% foreign-owned stock. Furthermore, the new corporation would continue to be considered a domestic company for U.S. tax purposes if the management and control remains in the U.S. and at least 25% of its employees, sales, or assets are located in the U.S. The Senate bill would apply to inversions for a two year period commencing on May 8, 2014. A companion bill (H.R. 4679) was introduced in the House which would make the changes permanent. However, the bills face opposition on the Hill with lawmakers indicating that the issue could be better solved as part of a broader tax overhaul. House Republicans favored pushing corporate tax rates lower as opposed to tightening inversion requirements, believing that the lower rates would give corporations an incentive to stay in the U.S. and invest, rather than go overseas for a better corporate tax rate. Senate Finance Committee Chairman Ron Wyden (D-Ore.) stated that he would consider the issue at a later time during a hearing on overhauling the international tax laws but would not introduce anti-inversion legislation nor would he sign onto the Levin bill. We agree that any changes to the inversion rules should not be made in isolation but as part of an overall rationalization of the U.S. international tax system.

G.A.O. REPORT QUESTIONS FOREIGN EARNED INCOME EXCLUSION

Government Accountability Office (“G.A.O.”) released a report on May 20, which considers retaining, modifying, or eliminating the foreign earned income exclusion (“F.E.I.E.”). Questioning the merit of the F.E.I.E. the G.A.O. said it is unclear that the continued tax relief for the relatively small population of U.S. citizens living and working abroad positively benefits the overall well-being of the United States population. Perhaps more importantly, the report cites a Joint Committee on Taxation estimate that eliminating F.E.I.E. would increase federal revenue by $6.8 billion in 2014 and $89 billion from 2013 to 2023, although one could argue the net economic effect of taxing all foreign earned income is uncertain. Currently, U.S. taxpayers working abroad may claim the exclusion under Section 911 to reduce taxable income up to an amount of $99,200 for 2014.[74]

I.R.S. CLARIFIES PROPOSED REGULATIONS ON PARTNERSHIP RECOURSE LIABILITIES

The I.R.S. has issued a correction to proposed regulations on partnership recourse liabilities,[75] which focus on the allocation of economic risk of loss among partners. The section clarifies that special rules applicable when an entity is structured to avoid related-person status will not be changed. Accordingly, under Treasury Reg. § 1.752-4(b)(2)(iv), which will be re-numbered as Treasury Reg. § 1.752-4(b)(4), a partner will continue to be treated as holding another entity's interest as a creditor or guarantor to the extent of the partner's or related person's ownership interest in the entity where the entity has lent to the partnership.

U.S. AND CANADA DEVELOPING "BEST PRACTICES" DOCUMENT

The I.R.S. and the Canada Revenue Agency ("C.R.A.") are developing a "best practices" document setting out agreed procedures for handling competent authority matters under the Canada-U.S. Tax Convention, a C.R.A. official said at the International Fiscal Association held in Toronto last month. The document will provide "very specific, practical things" that the U.S. and Canadian competent authorities will agree to, continually allowing improvement and efficiency between the parties. It will echo the parties' common understanding regarding the management of the U.S.-Canada mutual agreement procedure and advance pricing workload, including issues such as arrangements for negotiation meetings, exchange of documentation and coordination of interviews with taxpayer. The documents are treated as internal working documents and have not been publicly released. We welcome any potential improvements in the competent authority process, particularly given the significant number of cross-border U.S.-Canadian issues and related provisions of the U.S.-Canada Income Tax Treaty and Protocols that are specific to U.S.-Canada cross border transactions.

B.E.P.S. INTANGIBLE TRANSFER PRICING AND DEBT/EQUITY ISSUES ARE SEPARATE CONCERNS

In a comment of note, Branch Chief Christopher Bello, of the I.R.S. Office of Associate Chief Counsel (International) Branch 6, stated at a June 4th symposium that debt/equity characterization issues should be outside the scope of the O.E.C.D. project on transfer pricing of intangibles. Bello stated that if countries

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74 Full text of the GAO report can be found at http://www.gao.gov/assets/670/663322.pdf.

75 Proposed Regulations can be found at REG-136984-12, RIN 1545-BL21.

decide debt/equity characterization is an issue of concern to be dealt with internationally it could be targeted as a legitimate B.E.P.S. concern but that it did not need to be dealt with within the context of the arms-length principles of transfer pricing. We agree. The O.E.C.D. B.E.P.S. transfer pricing initiatives already have threshold issues on the table that could significantly change the transfer pricing landscape, such as positions with respect to allocation of income based on commercial risks and rewards of intangible property, country by country reporting, maintaining or perhaps re-defining the arms-length standard, etc. At this moment it is wise to allow taxpayers to choose how they finance their operations, by debt or equity, under existing rules.

B.E.P.S. INTANGIBLE TRANSFER PRICING CONT.

At the same June 4th symposium, the Treasury's Deputy Assistant Secretary for International Tax Affairs, Robert Stack, announced that according to the O.E.C.D. B.E.P.S. intangible property transfer pricing position, with respect to intangible-related returns, "capital gets a return once all the functions, assets and risks get an appropriate return." As far as the U.S. Treasury is concerned, this point is crucial to proper application of the arms-length standard, as defined by the U.S. government, and has apparently put the U.S. at odds with some trading partners, for whom it would effectively eliminate any intangible property profit at the source of the capital (think the Bermuda "cash box" paradigm, or as Mr. Stack described it, "two men and a dog"). The end result, according to Mr. Stack, will be an emphasis on functions and risks, recognizing that proper application of the arms-length standard can allocate profit to the source of the capital. We agree with the U.S. position in this regard and Mr. Stack's concern that the O.E.C.D. approach to intangible property transfer pricing and allocation of profits could get overly political. This would result from efforts by individual countries to allocate as much income as possible to their respective jurisdictions under the view of their own significance in contributing to the overall profitability of the intangible property. As to the Bermuda "cash box" paradigm, Mr. Stack indicated this might be dealt with under the auspices of the transfer pricing "special measures" consideration. This will have to be closely monitored as the "special measures" consideration has raised concerns in the worldwide taxpaying community.

TAXPAYER ADMITS TO CONCEALING $1 MILLION IN SWISS ACCOUNT FROM I.R.S.

In another example of the concerted I.R.S. and Justice Department joint enforcement of international reporting and compliance rules, a U.S. individual has pleaded guilty to willfully failing to file F.B.A.R.'s with the I.R.S. The individual had funds in a secret Swiss bank account that he maintained and controlled at Wegelin & Co., which is now defunct after pleading guilty in January 2013 to separate charges of assisting U.S. taxpayers in maintaining undeclared accounts.[76] The taxpayer opened the account when he was a Russian citizen. He emigrated to the

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[76] 03 DTR K-5, 1/4/14.

U.S. in 1984 and obtained U.S. citizenship in 1986. No F.B.A.R.'s were ever filed for the account. According to prosecutors, the taxpayer received $168,000 in cash distributions from his undeclared account in 2010 just before he closed the account and transferred the balance to his wife. The highest value of his account, for F.B.A.R. reporting purposes, was in excess of $1.5 million according to prosecutors. As part of his plea, the taxpayer agreed to $268,000 in back taxes plus more than $750,000 in civil penalties. In addition, sentencing will take place on September 11, 2014.

EX-UBS BANKER PLEADS GUILTY TO AIDING AND ABETTING TAX EVASION

On May 27, 2014, Martin Lack, an ex-UBS AG banker pleaded guilty to aiding wealthy Americans in evading taxes, while avoiding prison in *United States v. Lack*, S.D. Fla., No. 0:11-cr 60184. Lack, a Swiss resident and citizen, worked at UBS until 2002 before he founded his own firm based in Zurich, Lack & Partner Asset Management AG. Lack was charged in an indictment with conspiring from 1993 to 2010 in assisting American clients hide assets from the I.R.S. through accounts first at UBS, then at his firm. The court sentenced Lack to five years of probation and fined him $7,500 in a Fort Lauderdale federal court. In 2011, he was indicted, surrendered to U.S. authorities on October 14, 2013 and pleaded guilty on February 26. Since his indictment, Lack has been cooperating with prosecutors. Lack told U.S. District Court Judge William Dimitrouleas, "I apologize for my conduct and was given an opportunity to make amends," which he states was done to the best of his ability. Mr. Lack assisted many Americans, over a period of 17 years, in evading U.S. taxes by maintaining secret overseas Swiss bank accounts. Not only did Lack persuade Americans to evade U.S. taxes, he "solicited Americans to open undeclared accounts at UBS and cantonal bank because Swiss bank secrecy would conceal their ownership of the accounts," said U.S. prosecutors. Lack is not the first nor will he be the last in this process, as the U.S. government aggressively pursues Americans who have evaded taxes and those who have assisted them. Since 2009, over three-dozen foreign bankers, lawyers, and advisers have been charged. In addition, more than 70 U.S. taxpayers have been accused, and 13 Swiss banks are under criminal investigation by the U.S. government. As a result, 43,000 U.S. taxpayers have avoided prosecution and the possibility of criminal charges by entering into the O.V.D.P., paying taxes owed and penalties. U.S. taxpayers willing to take the risk of evading taxes should think twice, as the I.R.S. continues to aggressively pursue tax evaders with punishments of heavy penalties, interests, and the possibility of jail time.