UPDATES AND OTHER TIDBITS

Authors
Robert Rinninsland
Sheryl Shah
Cheryl Magat
Rusudan Shervashidze

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U.K. WINDFALL WINDING DOWN

After an arduous path through the courts regarding the creditability of the U.K. windfall tax, the Third Circuit followed the holding of the U.S. Supreme Court and found the tax to be creditable in a case involve PPL Corp.[103]

The U.S. and foreign countries can tax foreign-sourced income of U.S. taxpayers. To lessen the economic cost of double taxation, U.S. taxpayers are allowed to deduct or credit foreign taxes in computing income or net tax due. The amount of the U.S. income tax that can be offset by a credit cannot exceed the proportion attributable to net foreign source income. Code §901(b) specifies that a foreign credit is allowed only if the nature of the foreign tax is similar to the U.S. income tax and is imposed on net gain.

The U.S. entity PPL is a global energy company producing, selling, and delivering electricity through its subsidiaries. South Western Electricity PLC ("SWEB"), a U.K. private limited company, was an indirect subsidiary that was liable for windfall tax in the U.K. Windfall tax is a 23% tax on the gain from a company's public offering value when the company was previously owned by the U.K. government. When SWEB paid its windfall liability, PPL claimed a Code §901 foreign tax credit. This was denied by the I.R.S. and the long and winding litigation commenced.

Initially, the Tax Court found the windfall tax to be of the same character as the U.S. income tax. The decision was reversed by the Third Circuit Court of Appeals, which held that the tax was neither an income tax, nor a war profits tax, nor an excess profits tax. It took into consideration in determining the tax base an amount greater than gross receipts. Then, the Supreme Court reversed, finding that the predominant character of the windfall tax is an excess profits tax based on net income. Therefore, it was creditable. In August, the Third Circuit followed the Supreme Court's decision and ordered that the original decision in the Tax Court should be affirmed.

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[103] *PPL Corp. & Subs. v. Commr,* (CA 3 08/26/2014), reported unofficially at 114 AFTR 2d ¶2014-5190.

BIG WHOPPER OF A TAX SAVINGS

Burger King Worldwide Inc. ("Burger King") is moving its (tax) headquarters to Canada after an $11 billion buyout of the Canadian chain Tim Hortons Inc.

While there has been wide speculation regarding the motives for this transfer, Alex Behring, executive chair of Burger King and managing partner of its primary shareholder, 3G Capital, insists that the move was made for international growth rather than tax opportunities.

Under the current U.S. inversion rule, when a U.S. parent of a multinational company relocates its tax headquarters abroad, the ultimate U.S. tax liability on non-U.S. source income of affiliates is reduced as various provisions of the law – Code §61 never applies to the foreign shareholder and various provisions of Subpart F are inapplicable. Provided the move is approved, Burger King Worldwide Inc. will benefit from being taxed as a Canadian parent rather than American one. But such a move becomes problematic when 60% or more of the new parent company's shares continue to be held by the U.S. shareholders. Congressional bills such as the Stop Corporate Inversions Act of 2014 are directed at exactly this problem.

Besides the inversion impact, there are other legislative hurdles as well. Transactions involving substantial business activity in the foreign country similar to that in the U.S. are exempted from the inversion rule. However, Behring has his argument prepared. He claims that this transaction is mutually beneficial allowing the newly formed company to become an even larger fast food giant. This net benefit will need to be shown under the Investment Canada Act as well.

In addition to legislative hurdles, Burger King is facing pressure from senators to forego the move, claiming there will be a loss in customer loyalty and, ultimately, in sales. Objective evidence of this risk has not been made public by the senators. To date, there has been no incentive as significant as the projected $8.1 million in tax savings that would result from the move. The comments of the senators appear to be whopping big fabrications or "whoppers."

I.R.S. WARNS OF COSTLY PRANK CALLS

Over the summer, a number of taxpayers received unsolicited phone calls from persons claiming to be I.R.S. agents. These fake agents demanded money, often in an angry and threatening manner, and successfully duped taxpayers out of a reported total of $5 million. Over 90,000 complaints were received by the Treasury Inspector General for Tax Administration ("TIGTA"), who identified at least 1,100 victims in the fraud.

An audit released by the TIGTA shows that the I.R.S. engaged contract personnel who did not undergo the prescribed background investigations.[104] Couriers,

[104] Audit Report No. 2014-10-037, August 14, 2014.

printers, document recovery experts, and interpreters were given access to taxpayer data including names, addresses and social security numbers. In addition, the audit identified 20 contracts where personnel did not sign nondisclosure agreements.

While the I.R.S. works to rectify this breach, taxpayers are advised to remember that an initial communication from the I.R.S. will almost always take the form of official mail correspondence and not a cold call.

I.R.S. RELEASES NEW RULE ON I.T.I.N. TO EASE TAXPAYER BURDEN

The I.R.S. has recently taken steps to protect procedures involved in issuing the Individual Taxpayer Identification Number (the "I.T.I.N."), the nine-digit number issued to an individual who is required to have a U.S. taxpayer identification number but is not eligible to receive a social security number.

The I.R.S. began issuing the I.T.I.N. in 1996. Since that time, it has issued 21 million I.T.I.N.'s, but only a quarter of those issues are being used on U.S. tax returns.[105] In 2013, to protect the integrity of the program and safeguard the process, the I.R.S. established a rule under which new I.T.I.N.'s would automatically expire after five years.[106] This step was taken to ensure that I.T.I.N.'s were used for legitimate tax purposes.

On June 30th, the I.R.S. announced that it would stop automatically deactivating I.T.I.N.'s at the end of the five-year period. The new rule will apply to all I.T.I.N.'s, regardless of when they were issued. Under the new policy:

3. An I.T.I.N. will expire for any taxpayer who fails to file a federal income tax return for five consecutive years; and

4. Any I.T.I.N. will remain in effect as long as a taxpayer continues to file U.S. tax return (this includes I.T.I.N.'s issued after January 1, 2013).

To ease compliance procedures, the I.R.S. will not begin deactivating dormant I.T.I.N.'s until 2016.

According to Brenda Hales, a senior I.R.S. tax analyst, the new policy "will ensure that anyone who legitimately needs an I.T.I.N. for tax purposes can continue to do so, while at the same time resulting in the likely eventual expiration of millions of unused I.T.I.N.'s." If an I.T.I.N. has been deactivated, a taxpayer needing to file a U.S. return can reapply using Form W-7, *Application for IRS Individual Taxpayer Identification Number*. To file Form W-7 a taxpayer will need to submit original documents of identity by a foreign governmental authority or, if original documents cannot be submitted, copies of documents certified by the issuing governmental agency.

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[105] IR-2014-76, June 30, 2014.

[106] http://www.irs.gov/Individuals/Individual-Taxpayer-Identification-Number-(ITIN).

CHINA TAX AUTHORITIES FOCUS ON CROSS-BORDER SERVICE FEES, ROYALTIES

In what may be a significant transfer pricing initiative, China's central tax authority is coordinating a nationwide examination of cross-border I.P. and service fees, and local tax offices have been instructed to identify potential audit targets.

The period covered is from 2004 to 2013 and is expected to involve a number of transfer pricing audits with particular attention being given to payments made to companies in tax havens and other low-tax jurisdictions.

Service fees at issue would include fees for: (i) shareholder activities, (ii) management of the corporate group, (iii) services considered duplicative of those performed or supplied by third parties, (iv) services considered irrelevant to the Chinese entity based on its functions, risk profile, or business operations, and (v) services remunerated elsewhere.

Royalty payments at issue would include those made to entities incorporated in tax havens and those that serve no function or assume only a limited function, as well as large payments for intangibles that have depreciated in value.

The investigation will apparently apply to companies of all sizes including those who are not subject to transfer pricing documentation requirements under current Chinese law. This could be especially problematic for companies that are currently below the documentation thresholds, and advisors in China have recommended that such companies adopt procedures for capturing required documentation.

SINGAPORE PROPOSES NEW RULES REQUIRING EXPLANATION OF GLOBAL SUPPLY CHAINS

In a development somewhat similar to that in China, Singapore has proposed new transfer pricing documentation rules focused on contributions by related parties to an enterprise's global supply chains.

The proposed rules would require disclosure of the principal business activities and functions of each related party in the group, including charts showing the supply chains of products and services. The disclosures would include a functional analysis of each related party's value creation including the functions performed, risks assumed and assets. In addition, taxpayers would be required to disclose recent restructurings, acquisitions, and divestitures. If a holding company were a key member of the multinational group, taxpayers would have to provide an ownership chart showing the location and ownership linkages of the Singapore taxpayer with its ultimate holding company, intermediate holding companies, immediate holding company and all subsidiaries and associated companies directly and indirectly held by the Singapore taxpayer. An organogram showing the number of employees in each supply chain department would also be required.

These proposed rules have been issued under the auspices of Singapore's O.E.C.D.-based transfer pricing documentation regime put in place in February 2006.