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INSIGHTS

THE ITALIAN VOLUNTARY DISCLOSURE

J.C.T. REPORT ON COMPETITIVENESS – A STEP TOWARD CONSIDERATION OF NEW RULES

CORPORATE MATTERS: HELP – MY DELAWARE ENTITY HAS BEEN CANCELLED!

PRE-IMMIGRATION INCOME TAX PLANNING, PART II: COVERED EXPATRIATES

AND MORE

Insights Vol. 2 No. 4

TABLE OF CONTENTS

EDITORS' NOTE

In this month's edition of *Insights*, our articles address the following:

- **The Italian Voluntary Disclosure.** Stefano Grilli of Gianni, Origoni, Grippo & Cappelli Partners, Milan, explains the new Italian Voluntary Disclosure Program for offshore accounts and why this may be the last chance for amnesty.

- **Repatriation of Foreign Earnings v. Related Party Indebtedness.** Stanley C. Ruchelman and Sheryl Shah discuss the *BMC* case involving the interplay of the repatriation deduction under Code §965 and an account receivable that allows cash to be repatriated tax-free when an intercompany expense is determined to exceed an arm's length amount. The I.R.S. attempt to tie the two together in order to reduce the repatriation deduction was shot down.

- **J.C.T. Report on Competitiveness – A Step Toward Consideration of New Rules.** This month, our team delves into the Joint Committee Report addressing international tax reform in a series of articles. Stanley C. Ruchelman leads with comments on the J.C.T. analysis of Subchapter N of today's Code – the foreign provisions.

- **Competitiveness of the U.S. Tax System.** The Joint Committee Report compares the U.S. tax system with the systems of other countries. Stanley C. Ruchelman, Andrew P. Mitchel, and Sheryl Shah explain what the J.C.T. staff believes. It is not pretty.

- **Economic Distortions Arising from Deferral.** The Joint Committee Report explains what corporate tax executives know but most tax advisers and voters forget. The after-tax returns can be greater when one chooses to build a plant outside the U.S. Moreover, it never makes sense to repatriate the earnings and trigger the recognition of deferred tax expense. Is this the way to manage an economy? Christine Long comments.

- **Shifting Income and Business Operations.** The Joint Committee Report discovers that a better tax result is obtained when income is booked in low tax countries. Stanley C. Ruchelman and Kenneth Lobo explain.

- **Moving Deductions into the U.S. as a Tax Planning Strategy.** Taking a lead from the preceding article, the Joint Committee Report discovers that a better tax result is obtained when deductible expenses are booked in high tax countries. Stanley C. Ruchelman and Philip R. Hirschfeld explain.

- **"Helen of Troy" Inversions Continue.** The Joint Committee Report also discovers that a better tax result is obtained when foreign low-tax profits are removed from the U.S. tax stream, leaving more for shareholders and executives. Is it an inversion or merely self-help? Andrew P. Mitchel and Rusudan Shervashidze explain.

- **Corporate Matters: Help – My Delaware Entity Has Been Cancelled!** Simon H. Prisk explains why it is not the end of the world when a Delaware corporation is stricken off the corporate register for non-payment of state fees. Everyone is entitled to a second chance, including the stricken-off company.

- **Pre-Immigration Income Tax Planning, Part II: Covered Expatriates.** Those non-U.S. persons wishing to immigrate to the U.S. should understand how long they may remain in the U.S. before it is too expensive to leave. Galia Antebi and Kenneth Lobo explain.

- **F.A.T.C.A. 24/7.** In this month's edition of F.A.T.C.A. developments, Galia Antebi and Philip R. Hirschfeld address the following tidbits: (i) potential disagreement arises between the U.S. and I.G.A. jurisdictions on how to treat new individual accounts when self-certification follows several months after the account is opened; (ii) the I.R.S. announces the opening of the I.D.E.S. gateway for countries and financial institutions; (iii) new F.A.Q.'s clarify certain aspects of the requirement and deadline for filing Form 8966; (iv) South Africa publishes draft guidance on the implementation of the I.G.A.; (v) Mauritius will issue F.A.T.C.A. guidance; (vi) the U.S.-Singapore I.G.A. enters into force; (vii) Croatia and Belarus sign a Model 1 I.G.A.; and (viii) I.G.A. partner countries are listed.

We hope you enjoy this issue.

- The Editors

THE ITALIAN VOLUNTARY DISCLOSURE

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INTRODUCTION

Italy has a long history of tax amnesty programs[1] established under a broad variety of names and rules. Interestingly, every new program has been described as "the last chance" for tax evaders to comply with the Italian tax code. It is no wonder that, as in all prior cases, Italy's most recent voluntary disclosure program (the "V.D.") has been defined as the "last call." Having said that, and sensitive to prior performance, we firmly believe that for a wide range of reasons the V.D. will truly be the last opportunity for Italian citizens and residents to get their tax matters in order.

One indicator is heightened criticism of the typical Italian *de facto* tolerance toward tax evasion, which is now being blamed for the country's ongoing economic crisis. Accordingly, the war against tax havens, as initiated by the U.S. under F.A.T.C.A. and subsequent inter-governmental agreements, has changed the way the whole world approaches such matters. Today, there is a new sensitivity toward tax compliance and no discernable government or media tolerance towards tax avoidance.

In addition, a different approach is now being taken with respect to tax amnesty matters. In the past, there was a sort of "reward" for the penitent evaders. Such individuals were granted the opportunity to regularize their positions by paying a low flat-rate extraordinary tax. The V.D. is different. Under the new provisions of the Law n. 186, dated December 15, 2014, (the "V.D. Act"), a taxpayer who enters the V.D. procedure ("V.D. Applicant") will be required to pay every single euro of unpaid tax; the only benefit lies in the reduction of penalties, which are less than those applicable in an ordinary tax audit procedure.

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Beyond the elimination of rewards, the procedure requires an "all-in" disclosure. This means that (i) it will not be possible to regularize only a portion of foreign assets and/or foreign-source items of income while continuing to hide other assets and/or items of income, and (ii) the V.D. must cover all the taxable years with respect to which the statute of limitations has not expired.

Lastly, it should be noted that the V.D. is not a permanent procedure. In order to participate, the taxpayer must submit a specific request no later than September 30, 2015.

THE ITALIAN TAX SYSTEM: ORDINARY DISCIPLINE

To properly understand the objective scope of the V.D., the following discussion

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[1] Between 1991 and 2009, Italy approved four tax amnesty programs.

briefly describes the various tax compliance obligations that may be "cleared" through the disclosure program.

Italian Taxes

The V.D. covers noncompliance for income taxes (and related substitutive taxes), V.A.T., and I.R.A.P.[2] (collectively, the "Relevant Taxes"). Violations related to other taxes (*e.g.*, those regarding inheritance and donation or gift tax) are not covered by the V.D.

Under Italian tax law, the noncompliant tax return (*i.e.*, a tax return that fails to report the entire taxable base of the Relevant Taxes) is ordinarily penalized as follows:

- For Italian-source income, penalties range from 100% to 200% of the unpaid tax, and
- For foreign-source income, penalties range between 133% and 266% of the unpaid tax.

In addition, if assets and related items of income are located in a blacklisted jurisdiction:

- The statute of limitations is doubled from four to eight years[3] for the Relevant Taxes; and
- The penalties related to the unpaid taxes are doubled, ranging from 266% to 532% of the alleged unpaid tax.

"In addition to tax and penalties, Italian-resident individuals or entities other than companies that hold assets abroad must comply with declaratory duties and make certain disclosures to the Italian tax authorities."

R.W. Form

In addition to tax and penalties, Italian-resident individuals or entities other than companies that hold assets abroad must comply with declaratory duties and make certain disclosures to the Italian tax authorities ("I.T.A.") by filing a specific form (the "R.W. Form") as part of the taxpayer's return. This is the functional equivalent of the F.B.A.R. form that has galvanized the attention of U.S. taxpayers with foreign financial accounts, their tax advisers, and banks outside the U.S.

If the taxpayer is not compliant with R.W. Form filing duties, the penalties per year range as follows:

- From 3% to 15% of the value of the assets, if they are located in a whitelisted jurisdiction, and
- From 6% to 30% of the value of the assets, if they are located in a blacklisted jurisdiction.

Also, in the case of assets and related items of income located in a blacklisted jurisdiction:

- The statute of limitations with regard to the R.W. Form is increased from five to ten years, and

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[2] The regional tax on business activities.

[3] The statute of limitations is extended from five to ten years in the case of an omitted tax return.

- The assets are deemed to represent items of income not subject to tax, meaning that additional tax and penalties will be due. This is a rebuttable presumption.

Criminal Tax Penalties

In the event of breaches of Italian tax law, criminal issues also may arise. In particular, a tax return with undeclared income and tax qualifies as a criminal offense if two conditions are met: (i) unpaid taxes amount to €50,000 or more, and (ii) the undeclared tax base exceeds the greater of €2,000,000 or 10% of the declared tax base.

In the case of tax fraud, the criminal liability arises without reference to a specific threshold.

SUBJECTIVE SCOPE

Italian resident individuals or entities other than companies can initiate the V.D. program if the resident did not comply with R.W. Form filing duties in the relevant taxable years.

However, in order to include noncompliant taxpayers that did not hold assets abroad, a domestic V.D. program has also been introduced (the "Domestic V.D."). Often, Italian resident companies have been used by Italian resident individuals to divert untaxed income abroad.[4] In such cases, the V.D. allows the individual to clear the funds directly or indirectly deposited abroad in his or her name, while the Domestic V.D. allows the company to clear its position vis-à-vis the I.T.A.

Neither the V.D. nor the Domestic V.D. may be undertaken by those taxpayers (*i.e.*, individuals and/or companies) that have been officially informed that a tax audit or criminal tax investigation has been initiated against them. Again, this is similar to the program in the U.S., where taxpayers under I.R.S. examination, either directly or through a partnership or L.L.C., are not permitted to participate. The view is that these taxpayers are not acting voluntarily and the government does not benefit from disclosure because the persons are already known.

OBJECTIVE SCOPE

Benefits of Participation

Italian Taxes

There is no beneficial treatment concerning the evaded taxes. All taxes must be paid in full.

The only beneficial treatment concerns penalties, which are reduced. Within the

[4] For example, the tax record of an Italian resident company may reflect goods sold abroad at an amount below the actual price paid by the foreign customer. The difference is then diverted to a tax haven jurisdiction in the name of the Italian resident individual who owns the company. Conversely, the Italian resident company may record a higher price for goods acquired from abroad than the actual price paid to a foreign supplier, with the difference being diverted to a tax haven jurisdiction in the name of the Italian resident individual who owns the company.

applicable range, the lower rate will apply, with an additional 25% deduction. Interest on unpaid tax is due at an annual rate of 3.5%.

In addition, should the I.T.A. serve a notice of assessment on the basis of this disclosure, the taxpayer may achieve a further reduction in penalties. By accepting the notice, the taxpayer will be eligible for a reduced penalty rate of one-sixth of the amount imposed. Accordingly, the ultimate rate for penalties would be as follows:

- 12.5% of the assessed unpaid taxes with regard to domestic-source income, and
- 16.67% of the assessed unpaid taxes with regard to foreign-source income.

R.W. Form

Beneficial treatment for sanctions related to the omitted R.W. Form ("R.W. Sanctions") varies with respect to both the number of relevant taxable years and the rate of the sanctions. The V.D. distinguishes between income generated by (i) assets held in blacklisted jurisdictions and (ii) assets held in whitelisted jurisdictions or in blacklisted jurisdictions that have entered into an exchange of information agreement with Italy ("Quasi-White Jurisdictions").[5]

With respect to assets held in a whitelisted jurisdiction or Quasi-White Jurisdiction:

- Five taxable years are relevant (2009 to 2013), and
- The ultimate amount of the penalty corresponds to 0.5% of the value of the assets held abroad in each of those taxable years.

With respect to assets held in a blacklisted jurisdiction:

- Ten taxable years are relevant (2004 to 2013), and
- The ultimate amount of the penalty corresponds to 1% of the value of the assets held abroad in each of those taxable years.

In order to qualify for favorable treatment concerning the R.W. penalties, one of the following conditions must be fulfilled (the "R.W. Conditions"):

- The assets must be transferred to or held in Italy or in an E.E.A. Member State that allows for adequate exchange of information with Italy (an "Eligible State"), or
- If the assets remain in a jurisdiction other than an Eligible State, the V.D. Applicant must sign an authorization pursuant to which the financial institution where the assets are deposited is authorized to exchange information with the I.T.A. ("Waiver").

Should the R.W. Conditions not be met, the R.W. Sanction rates are increased as follows:

- 0.75% per year for assets held in a whitelisted jurisdiction or Quasi-White Jurisdiction; and

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5 These include Switzerland, the Principality of Liechtenstein, and the Principality of Monaco.

> *"The objective of the broad reporting net is to provide the I.T.A. with a full and clear understanding of the roles of all Related Taxpayers...to verify that the taxpayers autonomously chose to clear their positions through the V.D. procedure."*

- 1.5% per year for assets held in a blacklisted jurisdiction.

Criminal Tax Penalties

In the case of a successfully completed V.D., criminal tax offenses are no longer punishable. Therefore, in this respect, the V.D. qualifies as a form of amnesty.

Anti-Money Laundering Provisions

As suggested by G.A.F.I.,[6] voluntary disclosure programs adopted by individual Member States must not affect broader anti-money laundering provisions. Italy has been consistent in its compliance with this recommendation and the anti-money laundering provisions found in Italian domestic law are not violated by the V.D.

Additionally, the V.D. Act provides for a "self-laundering" offense to be inserted in the Italian criminal code. This new offense is not applicable with respect to the disclosures of a V.D. Applicant. Furthermore, the V.D. Applicant will not be prosecuted for criminal offenses related to pre-existing anti-money laundering provisions.

Related Taxpayers

The V.D. Act requires the V.D. Applicant to report the names of any individual or corporate taxpayers involved in the evasion of tax or in the holding of the foreign assets ("Related Taxpayers"). This includes any Italian resident person that participated in any way in the tax fraud that allowed the V.D. Applicant to hold undeclared assets abroad. Examples are any Italian resident person that either (i) managed the assets by proxy or (ii) was the co-owner of such assets. For example, consider a case where assets have been held abroad in the name of a husband and wife who issued a proxy entitling their son or daughter to manage the assets. Here, all parties should participate as V.D. Applicants, and each must report the names of the others on his or her V.D. application.

The objective of the broad reporting net is to provide the I.T.A. with a full and clear understanding of the roles of all Related Taxpayers, thereby allowing the I.T.A. to verify that the taxpayers autonomously chose to clear their positions through the V.D. procedure.

Interposed Persons

Where it is evident that assets were kept in the name of one party (the "Interposed Person")[7] while the actual rights to disposal and management of those assets belonged to another party, the Interposed Person may be disregarded. Consequently, the other party may consider itself to be the owner of the assets and any related items of income and may initiate the V.D. procedure with respect to the funds.

Procedural Aspects

The V.D. procedure requires the Italian taxpayer to submit an application to the I.T.A. for each of the relevant taxable years. In order to provide a better understanding of the related facts and circumstances, reporting must include the following:

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6 F.A.T.F., October 2012, "Best Practices: Managing the Anti-Money Laundering and Counter-Terrorist Financing Policy Implications of Voluntary Tax Compliance Programmes."

7 *E.g.*, a company, trust, foundation, or insurance company.

- The relevant taxable base and related taxes to be paid,
- Total assets kept abroad and the amount of R.W. Sanctions,
- Detailed information concerning the acquisition and maintenance of the foreign assets, and
- An itemized breakdown of unreported income with relevant supporting documentation.

CONCLUSIONS

In light of the foregoing, it is clear that the V.D. is similar in many aspects to the U.S. O.V.D.P. in its attempt to bring in recalcitrant taxpayers hiding assets abroad and to obtain information on financial and other enablers. It is an expensive procedure for noncompliant Italian taxpayers, especially when compared to previous tax amnesty programs enacted in Italy.

However, given the new global environment with regard to exchanges of information and recent treaty agreements between Italy and the Quasi-White Jurisdictions, the possibility of remaining hidden to the I.T.A. for future taxable years is almost nil. For depositors with Italian indicia who have closed accounts and transferred assets abroad, the I.T.A. may request data from tax authorities in the Quasi-White Jurisdictions, as well as of any jurisdiction that has committed to apply the Common Reporting Standard ("C.R.S.").[8] Undeniably, automatic exchange of information, as provided for by the O.E.C.D. Convention on Mutual Administrative Assistance in Tax Matters (which also imposes application of the C.R.S.), should make it difficult for an Italian resident to continue hiding undeclared foreign assets.

In light of the new criminal offenses enacted by the V.D. Act and the extremely onerous sanctions related to possession of undisclosed assets and income, the financial risk associated with remaining outside of the V.D. seems justified only by a vain and improbable hope that past practice will continue, with tax evaders receiving only a slap on the wrist. Italy has stepped into the global arena formed to stop cross-border tax evasion, and those who look to past practice may do so to their detriment.

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8 *I.e.*, a reporting standard based on the requirements imposed by the F.A.T.C.A. agreements.

REPATRIATION OF FOREIGN EARNINGS V. RELATED PARTY INDEBTEDNESS

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Tags
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Repatriation

On March 13, 2015, the United States Court of Appeals for the Fifth Circuit (the "Appeals Court") reversed a decision of the United States Tax Court regarding the rules relating to the repatriation of earnings under Code §965.

Code §965 was a temporary statute permitting an 85% dividends received deduction in connection with the repatriation of earnings from a foreign subsidiary as long as the proper tests were satisfied. One test related to intercompany loans to foreign subsidiaries allowing them to pay the low-tax dividends. Even though the statute is not currently in effect, the reasoning of the Appeals Court suggests that substance will at times prevail, even if it works against the I.R.S.

BMC Software, Inc. ("BMC") was a software developer that generated income from licensing operations. It had in effect a qualified joint cost-sharing agreement with a subsidiary. In 2002, the agreement was terminated and BMC began to pay royalties to the subsidiary in return for the transfer of rights back to BMC. In an I.R.S. examination, the arm's length nature of the royalty amount was challenged and ultimately was resolved through two closing agreements entered into in 2007. The first determined that the amount of an arm's length royalty was less than the amount paid. The second permitted BMC to treat the excess payment as a loan to the foreign subsidiary. This treatment, which has a long history in practice, was permitted under Rev. Proc. 99-32. As a result, the cash flow between BMC and its subsidiary was not changed but made to conform to the agreed amount of an arm's length royalty, and the return of the cash would be tax-free but for some deemed interest.

Unrelated to the I.R.S. examination and closing agreements, BMC received a qualifying cash dividend from its subsidiary and, pursuant to Code §965 in effect at the time, BMC claimed an intercompany dividends received deduction of $603 million, reflecting 85% of the dividend received. Code §965 allowed a one-time deduction of 85% of a dividend repatriation from a foreign subsidiary during the period 2003 to 2006. This provision was designed to encourage U.S. companies to unblock foreign earnings so that they could be paid into the U.S. economy. To prevent paper earnings without accompanying cash from qualifying for the deduction, Code §965(b)(3) prevents U.S. companies from making loans to foreign subsidiaries to fund repatriated dividends under Code §965. The repatriated dividends must be reduced by the amount of any increase in related party indebtedness held by a U.S. affiliate during a testing period beginning October 3, 2004 and ending at the close of the taxable year in which the dividend was paid.

In the course of examining the BMC tax return for 2006, the I.R.S. asserted that the deemed receivable arising from the closing agreement with the I.R.S. was an intercompany loan that was in existence in 2006 and that the amount of the deduction under Code §965 should be decreased by that receivable. This action reflected Notice 2005-64, which stated that accounts payable established under Code §482 adjustments should be treated as an indebtedness for purposes of §965(b)(3). The I.R.S. issued a deficiency notice and a petition was filed in the Tax Court.

The Tax Court upheld the I.R.S. determination and BMC appealed. The Appeals Court reversed. According to the Appeals Court, Code §965 specifically requires that the final amount of indebtedness must be determined by the close of the taxable year for which the election is being made. Since the taxable year was 2006, the relevant testing period ended on March 31, 2006. By March 31, 2006, the indebtedness did not exist because the accounts receivable did not exist, as the accounts receivable were created by the second agreement, which was closed in 2007. Even though the second agreement backdated the accounts receivable, it did not exist during the required period. Moreover, no cash in the form of a loan was actually advanced to the subsidiary during that period of time.

Although, I.R.S. Notice 2005-64 states that accounts payable established under Code §482 adjustments are treated as indebtedness for purposes of Code §965(b)(3), the Appeals Court did not defer to the I.R.S. position.[1] In comparison to a regulation, courts are free to judge whether the rationale and conclusion of a notice or a revenue ruling is persuasive.[2] Here, there was very little explanation or reasoning provided. Consequently, the Appeals Court concluded that Code §965 should be interpreted in accordance with its plain meaning.

The Appeals Court looked at the intent of BMC and the I.R.S. when entering into the second agreement, in order to determine whether BMC consented to having the accounts receivable treated as related party indebtedness for purposes of Code §965. The closing agreement never mentioned Code §965, and the boilerplate provision stating that the determination of the agreement was "for federal income tax purposes" was not sufficient to indicate consent, as the agreement specifically listed those tax implications that would occur as a result of the adjustment to the transfer price. No mention was made of the effect the agreement would have on the dividends received deduction under Code §965.

Consequently, the Appeals Court reversed the Tax Court decision and held that the meaning of the statute was plain and the accounts receivable adjustment fell outside the testing period. In addition, the boilerplate language could not be expanded to cover unlisted tax consequences. To do so would render the contract impermissibly broad and vague. Finally, the Appeals Court was not required to defer to the 2005 Notice, as it contained no persuasive reasoning.

1 Chevron USA, Inc. v. Natural Res. Def. Council, Inc., 104 S.Ct. 2778 (1984).

2 Skidmore v. Swift & Co., 65 S.Ct. 161 (1944).

J.C.T. REPORT ON COMPETITIVENESS – A STEP TOWARD CONSIDERATION OF NEW RULES

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Tags
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Effectively Connect Income
Entity Classification
F.D.A.P. Income
Source of Income
Transfer Pricing

INTRODUCTION

In a cross-border transaction of any kind, a minimum of three parties are immediate stakeholders with regard to the resulting income taxes, and that number can increase as a transaction increases in complexity. The first party consists of the business entity involved, and by this, we mean the multinational group of corporations ("M.N.G.") that may act through its members as the supplier and the purchaser of goods, services, and related intangible property ("I.P."). The second is the country of residence of the supplier of these items. The third is the country of residence of the purchaser of these items. Where the M.N.G.'s parent company is resident in yet another country, that country is a stakeholder, too.

The M.N.G. has as a primary tax-related goal the minimization of taxes in each country where a group member that participates in the transaction is resident. As a backup goal, the M.N.G. prefers that more of the income should be taxed in the hands of the member that will incur the lowest tax rate, either because the headline rate of tax is lower in that country or the member benefits from certain attributes, such as a net operating loss carryover.

In the country where the group member supplying the goods, services, or I.P. is resident, the goal of the tax authorities is to ensure that the transfer price received as consideration for the item is consistent with the views on arm's length transfer pricing adopted in that country. A similar view is shared by the tax authorities in the country where the purchaser is resident. However, because so much of transfer pricing analysis involves an exercise in subjectively selecting objective data, there is no reason to believe that the tax authorities of the two jurisdictions will come to the same result, even though they apply the same transfer pricing guidelines (O.E.C.D. Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations) or comparable guidelines (Arm's Length Transfer Pricing Regulations issued by the I.R.S.). In principle, this risk can be mitigated through a bilateral transfer pricing agreement.

In the country where the M.N.G.'s parent is located, the goal is to ensure that the controlled foreign corporation ("C.F.C.") rules adopted by that country are not abused by the group members involved in the transaction and that if one group member or the other benefits from I.P. developed by the parent, an appropriate amount of income is reported by the parent and taxed by its country of residence.

It takes little imagination to see that the tax situation of the M.N.G. can quickly become a "pig's breakfast" if countries do not apply similar rules to the cross-border transaction in a similar fashion. The result may easily be a jingoistic approach to taxation by tax authorities and a save-tax-at-all costs approach by M.N.G. management. After all, as one jurisdiction or another will likely take an aggressive view on its right to a share of the global tax revenue, it is prudent to start negotiations from a very low base. Each stakeholder involved blames the others when tax exposure explodes and the overall effect is a *sub rosa* impediment to global trade.

In this environment, the Joint Committee on Taxation published Present Law and Selected Policy Issues in the U.S. Taxation of Cross-Border Income (JCX-51-15) (the "J.C.T. Report"), on March 16, 2015, in connection with a public hearing on March 17, 2015, titled "Building a Competitive U.S. International Tax System." The J.C.T. Report is broken into several sections. Part I describes general international principles of taxation and how they are applied in the U.S. tax system. Part II provides an overview of U.S. present law related to the taxation of cross-border income. Part III discusses selected issues that have been of particular interest to policymakers concerned with the U.S. international tax system: the competitiveness of the U.S. tax system, economic distortions arising from deferral, shifting of income and business operations away from the United States, the tax incentive for locating deductions in the United States, and inversions. This article, and the articles that follow, address the points raised in the report. The starting point is an overview of the way the U.S. taxes domestic income of foreign corporations; non-resident, non-citizen individuals; and foreign income of U.S. corporations, citizens, and residents.

GENERAL OVERVIEW OF PRINCIPLES OF INTERNATIONAL TAXATION

According to the J.C.T. Report, a number of commonly accepted principles have developed to minimize the extent to which conflicts arise between countries as a result of extraterritorial or overlapping exercise of authority. International law generally recognizes the right of each sovereign nation to prescribe rules to regulate conduct with a sufficient nexus to the sovereign nation. The nexus may be between conduct and the territory of the nation or it may be between a person (whether natural or juridical) and the status of that person in the view of the sovereign nation.

"A number of commonly accepted principles have developed to minimize the extent to which conflicts arise between countries as a result of extraterritorial or overlapping exercise of authority."

These two broad bases of jurisdiction (*i.e.*, territoriality and nationality of the person whose conduct is regulated) have been refined and, in varying combinations, form the basis for most systems of income taxation. The J.C.T. Report points out that the broadest assertion of taxing authority, exercised on the basis of a person's status as a national, resident, or domiciliary of a jurisdiction, reaches worldwide activities of such persons. A more limited exercise of authority occurs when taxation is imposed only to the extent that activities occur, or property is located, in the territory of the taxing jurisdiction. If a person conducts business or owns property in a jurisdiction, or if a transaction occurs in whole or in part in a jurisdiction, the resulting limited basis of taxation is a territorial application.

No matter which system is adopted, a jurisdiction's identification of its tax base depends upon establishing rules for determining whether the income falls within its authority to tax. According to the J.C.T. Report, those rules sometimes turn on residency and lead to another set of rules that determine how to identify which persons have sufficient contact with a jurisdiction to be considered resident. For individuals, the test may depend solely upon nationality, physical presence, or a combination of the two. For entities, residency may require a more complex consideration of the level of activities within a jurisdiction.

The J.C.T. Report points out that mechanisms to eliminate double taxation must exist to address situations in which the source and residency determinations of the respective jurisdictions result in a duplicative assertion of taxing authority, as well as to permit limited mutual administrative assistance between jurisdictions. Potential double taxation is usually mitigated by operation of bilateral tax treaties or by legislative measures permitting credit for taxes paid to another jurisdiction. A multilateral approach may also be used. An example is the Base Erosion and Profit Shifting project of the O.E.C.D. In addition, the E.U. has introduced proposals that deny tax benefits in arrangements in which companies might otherwise derive low-tax or zero-tax cross-border income.

PRINCIPLES OF INTERNATIONAL TAXATION APPLIED BY THE U.S.

The J.C.T. Report points out that U.S. law adopts a hybrid system when it comes to the scope of imposing its jurisdiction to tax. It imposes taxation on the worldwide income of all U.S. citizens, U.S. residents that are not citizens, and domestic corporations. Under this system, all income is taxed, whether derived in the United States or abroad. In comparison, the U.S. imposes a territorial-based system on non-resident, non-citizen individuals and foreign entities. This system taxes U.S.-source income or income effectively connected with a U.S. trade or business. When the foreign entity is a subsidiary of a U.S. person, limited deferral is provided for foreign income.

This hybrid approach results in significant differences in tax treatment when comparing the scope of taxation imposed on U.S. persons investing abroad with the U.S. taxation of foreign persons investing in the United States. A U.S.-based M.N.G. is taxed, either currently or on a deferred basis, on all global income, with the timing of the tax controlled by the identity and residence of the member generating the income. In comparison, non-U.S. persons are generally subject to U.S. tax only on U.S.-source income. For these persons, the source of income generally determines whether current tax liability exists. In addition, the character of the income plays a part in determining whether the income will be taxed at all and, if it is, the mechanism by which it is taxed (*viz.*, by withholding or direct filing and payment).

U.S. source rules are not applied consistently across the board. Accordingly, the character of income will control which source rule applies:

- Compensation for personal services is generally sourced where the services are performed;
- Dividends and interest are sourced based on the residence of the taxpayer making the payments;
- Rents and royalties for the use of property are generally sourced based on the place where the property is used;
- Income from the sale of inventory is sourced, in general, where risk of loss passes to the purchaser; and
- Gains are sourced at the place of residence of the person deriving the gain.

Many exceptions exist to these broad rules.

Once the source of gross income is determined, the J.C.T. Report comments on the rules for the allocation of deductible expenses between U.S.-source income and foreign-source income. These rules do not generally affect the timing of expense deductions for period expenses attributable to items of actual or potential foreign-source income of a U.S. domestic corporation. In broad terms, a domestic corporation is generally allowed a current deduction for expenses, such as interest and administrative expenses, that support income derived through foreign subsidiaries and on which U.S. tax is deferred.

The expense allocation rules apply to a domestic corporation principally for determining the corporation's foreign tax credit limitation. This limitation is computed by reference to the corporation's U.S. tax liability on its taxable foreign-source income in each of two principal limitation categories. These categories are commonly referred to as the "general basket" and the "passive basket." Consequently, the expense allocation rules may prevent domestic taxpayers from fully utilizing their foreign tax credits because the taxpayer's own deductible expenses may artificially inflate the effective foreign tax rate by reducing taxable income.

The J.C.T. Report highlights the fact that U.S. tax law includes rules intended to prevent reductions to the U.S. tax base through structural changes. These include excessive borrowing in the United States to drive down income through excess borrowing costs,[1] migration of the tax residence of domestic corporations from the United States to foreign jurisdictions through corporate inversion transactions, or aggressive intercompany pricing practices with respect to I.P.

PRESENT LAW PRINCIPLES COMMON TO INBOUND AND OUTBOUND TAXATION

The J.C.T. Report recognizes that certain concepts apply to both inbound and outbound investment. Such areas include arm's length transfer pricing rules, entity classification rules, rules for determining the source of income, and rules for determining whether a corporation is foreign or domestic.

Transfer Pricing

The J.C.T. Report acknowledges that a basic U.S. tax principle applicable in dividing profits from transactions between related taxpayers is that the amount of profit allocated to each related taxpayer must be measured by reference to the amount of profit that a similarly situated taxpayer would realize in similar transactions with unrelated parties. Consequently, the J.C.T. Report states that the transfer pricing rules of Code §482 and the accompanying Treasury regulations are intended to preserve the U.S. tax base by ensuring that taxpayers do not shift income properly attributable to the United States to a related foreign company through pricing that does not reflect an arm's length result. Similarly, the domestic laws of most U.S. trading partners include rules to limit income shifting through transfer pricing.

The J.C.T. Report states that the arm's length standard is difficult to administer in situations in which unrelated-party market prices do not exist for transactions between related parties. However, taxpayers have applied arm's length transfer pricing rules

[1] See Code §163(j).

for many decades, and their returns have been reviewed and accepted both with and without adjustments by the I.R.S.

When a foreign person with U.S. activities has transactions with related U.S. taxpayers, the amount of income attributable to U.S. activities is determined in part by the same transfer pricing rules of Code §482 that apply when U.S. persons with foreign activities transact with related foreign taxpayers.

Code §482 authorizes the I.R.S. to allocate income, deductions, credits, or allowances among related business entities, when necessary, to clearly reflect income or otherwise prevent tax avoidance, and comprehensive Treasury regulations issued under that provision of U.S. tax law adopt the arm's length standard as the method for determining whether transaction values are appropriate. According to the J.C.T. Report, the regulations generally attempt to identify the respective amounts of taxable income of the related parties that would have resulted if the parties had been unrelated and dealing at arm's length.

"Code §482 authorizes the I.R.S. to allocate income, deductions, credits, or allowances among related business entities, when necessary, to clearly reflect income or otherwise prevent tax avoidance."

For income from I.P., Code §482 provides that the resulting income for the owner of the I.P. shall be commensurate with the income attributable to that intangible. This provision reflects a Congressional concern regarding the effectiveness of the arm's length standard with respect high-profit-potential intangibles. Acceptable measures of arm's length royalties for manufacturing I.P. include a fixed amount per unit, which does not reflect profit potential when the value of the I.P. increases over time.

Entity Classification

A business entity is generally eligible to choose how it is classified for Federal tax purposes under the "check-the-box" regulations. The J.C.T. Report explains that those regulations simplify the entity classification process for both taxpayers and the I.R.S. by making the entity classification of unincorporated entities explicitly elective in most instances. Eligibility of an entity, as well as the breadth of its choices, depends upon whether it is a "per se corporation" and the number of its beneficial owners.

For per se corporations, an election is not permitted. Generally, these are domestic entities formed under a State corporation statute. A number of specific types of foreign business entities are identified in the regulations as per se corporations. Typically, these entities are vehicles for a public offering of shares, such as P.L.C.'s in the U.K., S.A.'s in most French- and Spanish-speaking countries, and A.G.'s in German-speaking countries.

An eligible entity with two or more members may elect to be classified as a corporation or a partnership. If an eligible entity fails to make an election, default rules apply. A domestic entity with multiple members is treated as a partnership. A foreign entity with multiple members is treated as a partnership, if at least one member has unlimited liability, but is treated as a corporation if all members have limited liability.

The regulations also provide explicitly that a single-member unincorporated entity may elect either to be treated as a corporation or to be disregarded as not being separate from its owner for U.S. income tax purposes. A disregarded entity owned by an individual is treated in the same manner as a sole proprietorship. In the case of an entity owned by a corporation or partnership, the disregarded entity is treated in the same manner as a branch or division.

> *"The regulations extend elective classification to foreign, as well as domestic, entities."*

The J.C.T. Report explains that the regulations extend elective classification to foreign, as well as domestic, entities on the basis that the complexities and resources devoted to classification of domestic unincorporated business entities were mirrored in the foreign context. In actuality, the complexities were exacerbated in the international context, as the I.R.S. was making determinations in a world that did not contain the equivalent of a uniform statute such as the Uniform Partnership Act. As a result, a corporate law opinion based on the workings of foreign law was a prerequisite for the I.R.S. to issue a tax ruling. Also, the I.R.S. maintained the view at the time of the prior regulations that foreign laws were relevant only for purposes of explaining rights and obligations inherent in a foreign entity but not for tax treatment. The I.R.S. was not prepared to allow foreign tax treatment to control U.S. tax treatment. As a result, under the pre-1997 regulations and the check-the-box regulations, it is possible for an entity that operates across countries to elect into a hybrid status. "Hybrid entities" is a term that refers to entities treated as flow-through or disregarded entities for U.S. tax purposes, but as corporations for foreign tax purposes. Reverse hybrids also exist, typically where a partnership elects corporate status in the U.S. but retains tax transparent status abroad.

The existence of hybrid and reverse hybrid entities has various tax effects in the U.S. It can affect whether a taxpayer can use foreign tax credits attributable to deferred foreign-source income or income that is not taxable in the United States, as well as whether income of an offshore group is currently includible under Subpart F for the group's U.S. shareholders. For individuals, the use of a hybrid entity allows foreign corporate income taxes imposed on the hybrid to offset U.S. tax on the income of the hybrid that flows through to those individuals who are members.

Source of Income Rules

The J.C.T. Report addresses the rules for determining the source of certain types of income. Various factors determine the source of income for U.S. tax purposes, including the status or nationality of the payor, the status or nationality of the recipient, the location of the recipient's activities that generate the income, and the location of the assets that generate the income. If a payor or recipient is an entity eligible to elect its classification for Federal tax purposes, its choice of whether to be recognized as legally separate from its owner in another jurisdiction can affect the determination of the source of the income and other tax attributes, if the hybrid entity is disregarded in one jurisdiction but recognized in the other. To the extent that the source of income is not specified by statute, the I.R.S. may promulgate regulations that explain the appropriate treatment. However, many items of income are not explicitly addressed by either the Code or Treasury regulations, sometimes resulting in non-taxation of the income. On several occasions, courts have determined the source of such items by applying the rule for the type of income to which the disputed income is most closely analogous, based on all facts and circumstances.

Interest

Interest is derived from U.S. sources if it is paid by the United States government, any agency of the U.S. government, a State or any political subdivision thereof, or the District of Columbia. Interest is also from U.S. sources if it is paid by a resident or a domestic corporation on a bond, note, or other interest-bearing obligation. Special rules apply to treat as foreign-source (i) certain amounts paid on deposits with foreign commercial banking branches of U.S. corporations or partnerships and (ii) certain other amounts paid by foreign branches of domestic financial institutions.

Interest paid by the U.S. branch of a foreign corporation is also treated as U.S.-source income.

Dividends

Dividend income is sourced, generally, by reference to the payor's place of incorporation. Thus, dividends paid by a domestic corporation are generally treated as entirely U.S.-source income. Similarly, dividends paid by a foreign corporation are generally treated as entirely foreign-source income. In very limited circumstances, dividends may be treated in part as U.S.-source income under a relic of pre-branch profits tax law.

Rents and Royalties

Rental income is sourced by reference to the location, or place of use, of the leased property. The nationality or the country of residence of the lessor or lessee does not affect the source of rental income. Rental income from property located or used in the United States is U.S.-source income, regardless of whether the property is real or personal, intangible or tangible.

Royalties are sourced in the place of use of (or the place of privilege to use) the property for which the royalties are paid. This source rule applies to royalties for the use of either tangible or intangible property, including patents, copyrights, secret processes, formulas, goodwill, trademarks, trade names, and franchises.

Income from Sales of Personal Property

Subject to significant exceptions, income from the sale of personal property is sourced based on the residence of the seller. For this purpose, special definitions of the terms "U.S. resident" and "non-resident" are provided. A non-resident is defined as any person who is not a U.S. resident, a term that comprises any juridical entity that is a U.S. person and all U.S. citizens, as well as any individual who is a U.S. resident without a tax home in a foreign country or a non-resident alien with a tax home in the United States. As a result, a non-resident includes any foreign corporation.

Several special rules apply. For example, income from the sale of inventory property is generally sourced to the place of sale, as determined by the location where title to the property passes. However, if the sale is by a non-resident and is attributable to an office or other fixed place of business in the United States, it is treated as U.S.-source without regard to the place of sale, unless it is sold for use, disposition, or consumption outside the United States and a foreign office materially participates in the sale. Income from the sale of inventory property that a taxpayer produces in whole or in part in the United States and sells outside the United States, or that a taxpayer produces in whole or in part outside the United States and sells in the United States, is treated as partly U.S.-source and partly foreign-source.

In determining the source of gain or loss from the sale or exchange of an interest in a foreign partnership, the I.R.S. applies the asset-use test and business activities test at the partnership level to determine whether there is a U.S. business and, if so, the extent to which the income derived is effectively connected with that U.S. business. Implicit in this statement of the J.C.T. Report is the understanding that the I.R.S. view is not widely respected, as it is contrary to various provisions of the tax law dealing with partnerships and to at least one case expressly on this point in which the I.R.S. made the argument and lost. Legislation has been proposed in the Administration's budget for the past several years that would revise the law. Under the I.R.S. view, to the extent that there is unrealized gain attributable to partnership assets effectively connected with a U.S. business, the foreign person's gain or loss from the sale or exchange of a partnership interest is effectively connected gain or loss to the extent of the partner's distributive share of such unrealized gain or loss. Similarly, to the extent that the partner's distributive share of unrealized gain is attributable to a permanent establishment of the partnership under an applicable treaty provision, it may be subject to U.S. tax under a treaty.

Gain on the sale of depreciable property is divided between U.S.-source and foreign-source pools of gain in the same ratio that the depreciation was previously deducted for U.S. tax purposes, or could have been deducted if not actually claimed. Payments received on sales of I.P. are sourced in the same manner as royalties, to the extent that the payments are contingent on the productivity, use, or disposition of the I.P.

Personal Services Income

Compensation for labor or personal services is generally sourced to the place of performance. Thus, compensation for labor or personal services performed in the United States is treated generally as U.S.-source income, subject to a limited exception for *de minimis* amounts. Compensation for services performed both within and without the United States is allocated between U.S.-source and foreign-source income.

Insurance Income

Underwriting income from issuing insurance or annuity contracts is treated generally as U.S.-source income if the contract involves property in, liability arising out of an activity in, or the lives or health of residents of the United States.

Transportation Income

Generally, income from furnishing transportation that begins and ends in the United States is U.S.-source income. Typically, this rule is directed at cruises to nowhere and voyages from one city in the U.S. to another city where the route is in international water. Voyages that sail to a specific point outside the U.S. are not covered by this source rule, even if they do not end in a foreign country. Other income attributable to transportation beginning or ending in the United States is treated as 50% U.S.-source income, but it may be exempt under rules applicable to income from international shipping.

Income from Space or Ocean Activities or International Communications

In the case of a foreign person, generally no income from a space or ocean activity or from international communications is treated as U.S.-source income. With respect to the latter, an exception is provided if the foreign person maintains an office or other fixed place of business in the United States. In this case, the international communications income attributable to such fixed place of business is treated as U.S.-source income. For U.S. persons, all income from space or ocean activities and 50% of income from international communications are treated as U.S.-source income.

Amounts Received With Respect to Guarantees of Indebtedness

Amounts received, directly or indirectly, from a non-corporate resident or from a domestic corporation for the provision of a guarantee of indebtedness are income from U.S. sources. This includes payments made indirectly for the provision of a guarantee. For example, U.S.-source income under this rule includes a guarantee fee paid by a foreign bank to a foreign corporation for the foreign corporation's guarantee of indebtedness owed to the bank by the foreign corporation's domestic subsidiary, where the cost of the guarantee fee is passed on to the domestic subsidiary through additional interest charged on the indebtedness. In this situation, the domestic subsidiary has paid the guarantee fee as an economic matter through higher interest costs, and the additional interest payments made by the subsidiary are treated as indirect payments of the guarantee fee and, therefore, are U.S.-sourced.

Such U.S.-source income also includes amounts received from a foreign person, whether directly or indirectly, for the provision of a guarantee of indebtedness of that foreign person, if the payments received are connected with income of such person that is effectively connected with the conduct of a U.S. trade or business. Amounts received from a foreign person, whether directly or indirectly, for the provision of a guarantee of that person's debt, are treated as foreign source income if they are not from sources within the United States.

"A corporation is treated as domestic if it is incorporated under the laws of any State of the United States. All other corporations are treated as foreign."

Corporate Residence

The U.S. tax treatment of an M.N.G. depends significantly on whether the parent corporation of the group is domestic or foreign. For purposes of U.S. tax law, a corporation is treated as domestic if it is incorporated under the laws of any State of the United States. All other corporations are treated as foreign. A corporation that has dual charters is treated as a U.S. corporation. Other substantive factors that might be thought to bear on a corporation's residence are not relevant. These factors include (i) the location of the corporation's management activities, employees, business assets, operations, or revenue sources; (ii) the exchange or exchanges on which the corporation's stock is traded; and (iii) the country or countries of residence of the corporation's owners.

Only domestic corporations are subject to U.S. tax on a worldwide basis. Foreign corporations are taxed only on income that has a sufficient connection with the United States.

To the extent that the U.S. tax rules impose a greater burden on a domestic multinational corporation than on a similarly situated foreign multinational corporation, the domestic multinational company may have an incentive to undertake a restructuring, merger, or acquisition that has the consequence of replacing the domestic parent company of the multinational group with a foreign parent company. This sort of transaction, in which a foreign corporation replaces a domestic corporation as the parent company of a multinational group, has been commonly referred to as an inversion. Subject to the Code's anti-inversion rules and other provisions (*e.g.*, those related to outbound transfers of stock and property, deductibility of related-party interest payments, and a foreign subsidiary's investment in U.S. property), an inversion transaction might be motivated by various tax considerations. These include the removal of a group's foreign operations from the U.S. taxing jurisdiction and the potential for reduction of U.S. tax on U.S.-source income through excessive payments of deductible interest or royalties from a U.S. subsidiary to the new foreign parent company.

Until 2004, U.S. tax law included no rules that specifically addressed inversion transactions, although the regulations issued under Code §367(a) contained gain recognition rules that were found by Congress to be ineffective in certain circumstances. Shareholder gain recognition is meaningless for a shareholder that is not a U.S. person or that is tax exempt. Even if a shareholder is a domestic person, gain recognition is irrelevant on a current basis if the share value is significantly below basis. Corporate gain recognition may be immaterial if the company can shield the tax through the use of certain tax attributes, such as net operating losses and credits. Consequently, until Code §7874 was enacted, a domestic corporation could be redomiciled in another country with limited U.S. tax consequences to the corporation or its shareholders.

Code §7874 adopts anti-inversion toll charge rules, which provide that during the ten-year period following the inversion transaction corporate-level gain recognized in connection with the inversion generally may not be offset by tax attributes such as net operating losses or foreign tax credits.

These sanctions generally apply to a transaction in which, pursuant to a plan or a series of related transactions:

- A domestic corporation becomes a subsidiary of a foreign incorporated entity or otherwise transfers substantially all of its properties to a foreign incorporated entity;
- The former shareholders of the domestic corporation hold at least 60% but less than 80% of the foreign-incorporated entity, measured by vote or value, by reason of the stock they had held in the domestic corporation; and
- The foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50% ownership, does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group.

"Non-resident, non-citizen individuals and foreign corporations are generally subject to U.S. tax only on U.S.-source income. Thus, the source and type of income received by a foreign person generally determines whether there is any U.S. income tax liability."

In addition, an excise tax is imposed under Code §4985 on certain stock compensation of executives.

If a transaction otherwise satisfies the requirements for applicability of the anti-inversion rules and the former shareholders of the domestic corporation end up holding 80% or more of the stock of the foreign-incorporated entity after the transaction, the anti-inversion rules deem the new top-tier foreign corporation to be a domestic corporation for all Federal tax purposes.

Similar rules apply if a foreign corporation acquires substantially all of the properties constituting a trade or business of a domestic partnership.

U.S. TAX RULES APPLICABLE TO NON-RESIDENT, NON-CITIZEN INDIVIDUALS AND FOREIGN CORPORATIONS

Non-resident, non-citizen individuals and foreign corporations are generally subject to U.S. tax only on U.S.-source income. Thus, the source and type of income received by a foreign person generally determines whether there is any U.S. income tax liability and the mechanism by which it is taxed. The U.S. tax rules for U.S. activities of foreign taxpayers apply differently to two broad types of income:

- U.S.-source income that is "fixed or determinable annual or periodical gains, profits, and income" ("F.D.A.P. income"), and
- Income that is effectively connected with the conduct of a trade or business within the United States ("E.C.I.").

F.D.A.P. income generally is subject to a 30% gross-basis withholding tax, while E.C.I. is generally subject to the same U.S. tax rules that apply to business income derived by U.S. persons. Deductions are permitted in determining the tax base, and the tax is imposed at the same rates applicable to U.S. persons filing similar returns – married persons filing separately or single individuals. F.D.A.P. income in the form of portfolio interest is exempt from withholding tax and other F.D.A.P. income is subject to a reduced rate of tax or an exemption under a bilateral income tax treaty.

Gross-Basis Taxation of U.S.-Source Income

Non-business income received by foreign persons from U.S. sources is generally subject to tax on a gross basis at a rate of 30%, which is collected by withholding at the source of the payment. The items of F.D.A.P. income enumerated in Code §§871 and 881 are illustrative. The common characteristic is that taxes with respect to the income may be readily computed and collected at the source, in contrast to the administrative difficulty involved in determining the seller's basis and resulting gain from sales of property.

Types of F.D.A.P. Income

F.D.A.P. income encompasses a broad range of gross income but has limited application to gains on sales of property, including market discount on bonds and option premiums.

- Capital gains received by non-resident aliens present in the United States for fewer than 183 days are generally treated as foreign source and are thus not subject to U.S. tax, unless the gains are effectively connected with a U.S. trade or business. U.S.-source capital gains received by non-resident, non-citizen individuals present in the United States for 183 days or more are subject to gross-basis taxation. Typically, only students and persons who are not employed or have no fixed place of business are caught by this test, as those are typically the only non-resident, non-citizen individuals who would have U.S.-source gains. The reason is that residence controls the source of gains, and residence for this purpose is defined in Code §865(g). For a person who is not a tax resident of the U.S., as defined in Code §7701(b), the source of the gain is controlled by the place where a "tax home" is maintained by the individual. If a non-resident, non-citizen individual is present in the U.S. for at least 183 days, but has a tax home outside the U.S., any gain derived during the year is considered to be a foreign-source gain, absent unusual circumstances or a sale involving U.S. real property.
- U.S-source gains from the sale or exchange of intangibles are subject to tax if the amount of the sales proceeds is contingent upon productivity of the property sold and they are not effectively connected with a U.S. trade or business.

- Interest paid with respect to deposits with domestic banks and savings and loan associations, and certain amounts held by insurance companies, are U.S.-source but are not subject to the U.S. withholding tax when paid to a foreign person, unless the interest is effectively connected with a U.S. trade or business of the recipient. Interest on deposits with foreign branches of domestic banks and domestic savings and loan associations is not treated as U.S.-source income.

- Interest and original issue discount on certain short-term obligations having a maturity of not more than 183 days after the date of issuance are also exempt from U.S. withholding tax when paid to a foreign person.

- U.S.-source portfolio interest is specifically exempt from the 30% withholding tax. Portfolio interest is any interest that is paid on an obligation that is in registered form as to payments of interest and principle and for which the beneficial owner has provided to the U.S. withholding agent a statement certifying that the recipient is not a U.S. person. Portfolio interest does not include interest received by a 10% shareholder determined after application of ownership attribution rules, contingent interest, interest received by a C.F.C. from a related person, and interest received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of a banking trade or business.

Imposition of Gross-Basis Tax and Reporting by U.S. Withholding Agents

The 30% tax on F.D.A.P. income is generally collected by means of withholding. Withholding on F.D.A.P. payments to foreign payees is required unless the withholding agent can establish that the beneficial owner of the amount is eligible for an exemption from or a reduced rate of withholding under an income tax treaty.

With respect to the income from which tax was withheld, the foreign recipient is not required to file a U.S. Federal income tax return if the recipient has no E.C.I. and the withholding is sufficient to satisfy the tax liability. Accordingly, although the 30% gross-basis tax is a withholding tax, it is also generally the final tax liability of the foreign recipient. Note, however, that if no tax return is filed, the period of limitations within which the I.R.S. can assert additional tax never begins to run.

A withholding agent that makes payments of U.S.-source amounts to a foreign person is required to report and remit any amounts of U.S. tax withheld. Two types of reports are required by March 15 of the following calendar year: (i) a summary of the total U.S.-source income paid and withholding tax withheld on foreign persons for the year, and (ii) a report to both the I.R.S. and the foreign person of the person's U.S.-source income that is subject to reporting.

The non-resident withholding rules apply broadly to any financial institution or other payor, including foreign financial institutions. To the extent that the withholding agent deducts and withholds an amount, the withheld tax is credited to the recipient of the income. If the agent withholds more than is required, the excess may be returned to the recipient upon filing of a timely U.S. tax return claiming a refund of excess tax.

Excise Tax on Foreign Reinsurance Premiums

An excise tax applies to premiums paid to foreign insurers and reinsurers covering U.S. risks. The excise tax is imposed on a gross basis at a rate of 1% on reinsurance and life insurance premiums, and 4% on property and casualty insurance premiums. The excise tax does not apply to premiums that are effectively connected with the conduct of a U.S. trade or business or that otherwise are exempted under an applicable income tax treaty. The excise tax paid by one party cannot be credited if, for example, the risk is reinsured with a second party in a transaction that is also subject to excise tax.

Many U.S. tax treaties provide an exemption from the excise tax, including those with Germany, Japan, Switzerland, and the U.K. Such treaties generally include an anti-conduit rule to prevent inappropriate claims of treaty benefits. The most common anti-conduit rule provides that the treaty exemption applies to the excise tax only to the extent that the underlying risks are not reinsured with a person not entitled to the benefits of a treaty.

Net-Basis Taxation of U.S.-Source Income

Income from a U.S. Business

Net-basis taxation is imposed on the income of foreign persons that is "effectively connected" with the conduct of a trade or business in the United States. Any gross income derived by the foreign person that is not effectively connected with the person's U.S. business is not taken into account in computing this tax.

U.S. Trade or Business

A foreign person is subject to U.S. tax on a net basis if the person is engaged in a U.S. trade or business. Partners in a partnership and beneficiaries of an estate or trust are treated as engaged in the conduct of a trade or business within the United States if the partnership, estate, or trust is so engaged.

Whether a foreign person is engaged in a U.S. trade or business is a factual question. Basic issues include whether the activity constitutes business rather than investing, whether sufficient activity is conducted in the United States – "considerable, continuous, and regular" – in connection with that business, and whether the relationship between the foreign person and the persons performing functions in the United States in respect of the business is sufficient to attribute those functions to the foreign person.

The trade or business rules differ from one activity to another. The term "trade or business within the United States" expressly includes the performance of personal services within the United States. This is subject to $3,000 and 90-day *de minimis* rules.

Detailed rules govern whether trading in stocks, securities, or commodities constitutes the conduct of a U.S. trade or business. A foreign person who trades in stocks, securities, or commodities in the United States through an independent agent is not generally treated as engaged in a U.S. trade or business if the foreign person does not have an office or other fixed place of business in the United States through which trades are carried out. A foreign person who trades stocks, securities, or commodities for their own account rather than for customers generally is not considered to be engaged in a U.S. business, so long as the foreign person is not a dealer in stocks, securities, or commodities (*i.e.*, a person who sells to customers in the ordinary course of a trade or business). This should be compared with a long-term investor or short-term trader that sells into the market and has no customers.

For eligible foreign persons, U.S. bilateral income tax treaties restrict the application of net-basis U.S. taxation. Where a treaty is applicable, a U.S. permanent establishment must exist for the U.S. to impose tax on the business profits. The threshold level of activities that constitute a permanent establishment is generally higher than the threshold level of activities that constitute a U.S. trade or business.

The threshold for a permanent establishment includes the maintenance of a fixed place of business over a significant period of time. Among the specified inclusions are (i) places of management, (ii) branches, (iii) offices, (iv) factories, (v) workshops, and (vi) mine, oil or gas wells, and quarries.

Other activities are specifically excluded, such as one or more of the following: (i) use of facilities solely for the purpose of storage, display, or delivery of goods; (ii) maintenance of a stock of goods or merchandise, itself, if in the United States for the purpose of storage, display, or delivery; (iii) maintenance of a stock of goods or merchandise solely for the purpose of processing by another enterprise; (iv) maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise; and (v) maintenance of a fixed place of business solely for the purpose of carrying on an activity of a preparatory or auxiliary character.

Effectively Connected Income

Specific statutory rules govern whether income is E.C.I. In the case of U.S.-source capital gains and U.S.-source income of a type subject to gross-basis U.S. taxation, the factors taken into account include whether the income is derived from assets used, or held for use, in the conduct of the U.S. trade or business and whether the activities of such a trade or business were a material factor in the realization of the amount (the "asset use" and "business activities" tests). Under these tests, due regard is given to whether the income, gain, or asset was accounted for through the U.S. trade or business. All other U.S.-source income is treated as E.C.I.

Only limited categories of foreign-source income may be characterized as E.C.I., and only if the foreign person is engaged in a U.S. trade or business and maintains an office or other fixed place of business within the United States to which the income is attributable. The limited categories are as follows:

- Rents or royalties for the use of patents, copyrights, secret processes or formulas, goodwill, trade-marks, trade brands, franchises, or other like intangible properties;
- Interest or dividends derived in the active conduct of a banking, financing, or similar business within the United States or received by a corporation the principal business of which is trading in stocks or securities for its own account; and
- Income derived from the sale or exchange outside the United States of inventory property held by the foreign person primarily for sale to customers in the ordinary course of its business.

Regarding the third category, a sale is not included if it is made for use, consumption, or disposition outside the United States and an office or other fixed place of business in a foreign country participated materially in the sale. Regarding the first and second categories, foreign-source dividends, interest, and royalties are not treated as E.C.I. if the items are paid by a foreign corporation in which more than 50% by vote is owned directly, indirectly, or constructively by the recipient of the income.

"If a U.S. office or fixed place of business exists, income, gain, deduction, or loss is considered attributable to the office only if the office is a material factor in the production of the income and it regularly carries on activities of the type from which the income is derived."

In determining whether a foreign person has a U.S. office or other fixed place of business, the office or other fixed place of business of an agent generally is disregarded. However, if the agent is not independent, the agent's place of business may be attributed to the foreign person if the agent has and regularly exercises the authority to negotiate and conclude contracts in the name of the foreign person or has a stock of merchandise from which orders are regularly filled on behalf of the foreign person.

If a U.S. office or fixed place of business exists, income, gain, deduction, or loss is considered attributable to the office only if the office is a material factor in the production of the income and it regularly carries on activities of the type from which the income is derived.

Special rules apply in determining the E.C.I. of an insurance company. The foreign-source insurance income of a foreign corporation is E.C.I. if it is attributable to its United States business.

Income, gain, deduction, or loss for a particular year generally is not treated as E.C.I. if the foreign person is not engaged in a U.S. trade or business in that year and the income is attributable to activities in that year. However, significant exceptions exist to this rule. If the income or gain is attributable to the sale or exchange of property, the performance of services, or any other transaction that occurred in a prior taxable year, the income or gain is taxable on a net basis in the year received if the income would have been E.C.I. in the earlier year. In addition, if any property ceases to be used or held for use in connection with the conduct of a U.S. trade or business and the property is disposed of within ten years after the cessation, the income or gain is taxable on a net basis as if the disposition occurred immediately before the property ceased to be used in connection with the U.S. trade or business.

Allowance of Deductions

Taxable E.C.I. is computed by taking into account deductions associated with gross E.C.I. For this purpose, the apportionment and allocation of deductions other than interest is addressed in detailed regulations. In some circumstances, deductions may be allocated on the basis of units sold, gross sales or receipts, costs of goods sold, profits contributed, expenses incurred, assets used, salaries paid, space used, time spent, or gross income received. More specific guidelines are provided for the allocation and apportionment of research and experimental expenditures, legal and accounting fees, income taxes, losses on dispositions of property, and net operating losses. Detailed regulations address the allocation and apportionment of interest deductions. In general, interest expense is allocated and apportioned based on the deployment of a foreign company's assets, rather than its income.

Special Rules

F.I.R.P.T.A.

The Foreign Investment in Real Property Tax Act of 1980 ("F.I.R.P.T.A.") generally treats a foreign person's gain or loss from the disposition of a U.S. real property interest ("U.S.R.P.I.") as E.C.I. that is taxable at the income tax rates applicable to U.S. persons, including the rates for net capital gains. In the case of a foreign corporation, the gain from the disposition of a U.S.R.P.I. may also be subject to the branch profits tax at a 30% rate or a reduced rate under an applicable income tax treaty. Branch profits tax is not applicable if the U.S.R.P.I. consists of shares of a U.S. Real Property Holding Corporation.

The purchaser of the U.S.R.P.I. is generally required to withhold U.S. tax from the payment. Withholding is generally imposed at the rate of 10% of the sales price. If a foreign person receives a distribution from a real estate investment trust ("R.E.I.T.") or regulated investment company ("R.I.C."), the withholding tax rate is 35% of the distribution to the extent attributable to a sale of a U.S.R.P.I. by the R.E.I.T. or R.I.C. If the withholding tax exceeds the actual net income tax due, a refund may be claimed through the filing of a U.S. tax return.

Branch Profits Tax

A domestic corporation owned by foreign persons is subject to U.S. income tax on its net income. The earnings of the domestic corporation are subject to a second tax at the shareholder level when dividends are paid. The second-level tax is imposed at a flat rate and collected by withholding. Unless the portfolio interest exemption, a treaty, or another exemption applies, interest payments made by a domestic corporation to foreign creditors are subject to U.S. withholding tax, as well. To approximate these second-level withholding taxes, the United States taxes a foreign corporation that is engaged in a U.S. trade or business through a U.S. branch on amounts of U.S. earnings and profits that are shifted out of, or amounts of interest that are deducted by, the U.S. branch of the foreign corporation. These branch taxes may be reduced or eliminated under an applicable income tax treaty.

Under the branch profits rule, the United States imposes a tax of 30% on a foreign corporation's "dividend equivalent amount." The dividend equivalent amount is generally the earnings and profits of a U.S. branch of a foreign corporation attributable to its E.C.I. Limited categories of such income are excluded in calculating the dividend equivalent amount.

In arriving at the dividend equivalent amount, a branch's effectively connected earnings and profits are adjusted to reflect changes in a branch's U.S. net equity. The first adjustment reduces the dividend equivalent amount to the extent the branch's earnings (i) are reinvested in trade or business assets in the United States or (ii) reduce U.S. trade or business liabilities. The second adjustment increases the dividend equivalent amount to the extent that prior reinvested earnings are considered remitted to the home office of the foreign corporation.

Generally, interest paid by a U.S. trade or business of a foreign corporation is treated as if paid by a domestic corporation and therefore subject to U.S. 30% withholding tax. Certain "excess interest" of a U.S. trade or business of a foreign corporation is treated as if paid by a U.S. corporation to a foreign parent and, therefore, is subject to U.S. 30% withholding tax. For this purpose, excess interest is the excess of the interest expense of the foreign corporation apportioned to the U.S. trade or business over the amount of interest paid by the trade or business.

Earnings Stripping

U.S. corporations that are owned by foreign persons are limited in their ability to reduce their U.S. tax base through certain earnings stripping transactions involving interest payments. If the U.S. payor's debt-to-equity ratio exceeds 1.5 to 1, a deduction for disqualified interest paid or accrued by the payor in a taxable year is generally disallowed to the extent of the payor's excess interest expense. This rule is applied after the status of the debt as "true debt" for U.S. income tax purposes is determined. Disqualified interest includes (i) interest paid or accrued to related parties when no Federal income tax is imposed, (ii) interest paid to unrelated parties in certain instances in which a related party guarantees the debt ("guaranteed debt") and withholding tax is not imposed, and (iii) interest paid to a R.E.I.T. by a taxable R.E.I.T. subsidiary.

Excess interest expense is the amount by which the payor's net interest expense (*i.e.*, the excess of interest paid or accrued over interest income) exceeds 50% of its adjusted taxable income. In broad terms, adjusted taxable income is equivalent to earnings before interest, taxes, depreciation, and amortization ("E.B.I.T.D.A."), with adjustments to eliminate net operating loss carryovers and domestic production activities under Code §199.

Interest amounts disallowed under these rules can be carried forward indefinitely and are allowed as a deduction to the extent of excess limitation in a subsequent tax year. In addition, any excess limitation can be carried forward three years.

U.S. TAX RULES APPLICABLE TO FOREIGN ACTIVITIES OF U.S. PERSONS (OUTBOUND)

In General

In broad terms, the U.S. does not impose an income tax on foreign corporations on income earned from foreign operations, whether or not some or all its shareholders are U.S. persons. Generally, income earned by a U.S.-based M.N.G. from foreign operations conducted by the group's foreign corporate members is subject to U.S. tax when the income is distributed as a dividend to the domestic parent corporation. Until that repatriation, the U.S. tax on the income is generally deferred until distributed to a U.S. shareholder or a U.S. shareholder recognizes gain on the sale of stock.

Having said that, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States on certain categories of passive or highly mobile income earned by its foreign corporate subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the C.F.C. rules known as "Subpart F" and the foreign fund rules known as "Passive Foreign Investment Company" or, more commonly, "P.F.I.C." rules. A foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign-source income, whether the income is earned directly by the domestic corporation, repatriated as an actual dividend, or included in the domestic parent corporation's income under one of the anti-deferral regimes.

Anti-Deferral Regimes

Subpart F

> ***"Subpart F, applicable to C.F.C.'s and their 'U.S. Shareholders,' is the main anti-deferral regime of relevance for a U.S.-based multinational corporate group."***

Subpart F, applicable to C.F.C.'s and their "U.S. Shareholders," is the main anti-deferral regime of relevance for a U.S.-based multinational corporate group. A C.F.C. is generally defined as any foreign corporation whose U.S. Shareholders own (directly, indirectly, or constructively) more than 50% of the corporation's stock (measured by vote or value). For this purpose, a U.S. Shareholder is a U.S. person that owns stock representing at least 10% of the voting power of the foreign corporation. Under the Subpart F rules, the United States generally taxes U.S. Shareholders of a C.F.C. on their *pro rata* shares of certain income of the C.F.C. (referred to as "Subpart F Income"). Distributions are not necessary for tax to be imposed.

With exceptions described below, Subpart F Income generally includes passive income and other income that is readily movable from one taxing jurisdiction to another. Subpart F Income consists of "Foreign Base Company Income," "Subpart F Insurance Income," and certain income relating to international boycotts and other violations of public policy. Foreign Base Company Income consists of "Foreign Personal Holding Company Income," which includes passive income such as dividends, interest, rents, and royalties, and a number of categories of income from business operations, including "Foreign Base Company Sales Income," "Foreign Base Company Services Income," and "Foreign Base Company Oil-Related Income." Insurance income subject to current inclusion under the Subpart F rules includes any income of a C.F.C. attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the C.F.C.'s country of organization." Subpart F Insurance Income also includes income attributable to an insurance contract in connection with risks located within the C.F.C.'s country of organization as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of risks in other countries.

Special rules apply under Subpart F with respect to "Related Person Insurance Income." For purposes of these rules, the U.S. ownership threshold for C.F.C. status is reduced to 25%. Any U.S. person who owns or is considered to own any stock in a C.F.C. is treated as a U.S. Shareholder for purposes of this 25% U.S. ownership threshold and exposed to current tax on the corporation's Related-Person Insurance Income. Related Person Insurance Income is defined for this purpose as any Subpart F Insurance Income attributable to a policy of insurance or reinsurance with respect to which the primary insured is either a U.S. Shareholder in the C.F.C. or a person related to such a shareholder.

Detailed exceptions are provided for certain C.F.C.'s maintaining active operations in the country of incorporation or the country of a qualified business unit ("Q.B.U.") of the C.F.C.

Investments in U.S. Property

The U.S. Shareholders of a C.F.C. are required to include currently in income for U.S. tax purposes their *pro rata* shares of the corporation's untaxed earnings invested in certain items of U.S. property. U.S. property generally includes (i) tangible property located in the United States, (ii) the stock of a U.S. corporation, (iii) an obligation of a U.S. person, and (iii) certain intangible assets, such as patents and copyrights, acquired or developed by the C.F.C. for use in the United States.

Specific exceptions apply, including (i) bank deposits, (ii) certain export property, and (iii) certain trade or business obligations. The inclusion rule for investment of earnings in U.S. property is intended to prevent taxpayers from avoiding U.S. tax on dividend repatriations by repatriating C.F.C. earnings through non-dividend payments, such as loans to U.S. persons or acquisition of plants leased to related and unrelated U.S. persons.

Subpart F Exceptions

A provision colloquially referred to as the "C.F.C. look-through" rule, which is applicable for taxable years beginning after 2005 and before 2015, excludes from Foreign Personal Holding Company Income the dividends, interest, rents, and royalties received or accrued by one C.F.C. from a related C.F.C. to the extent that they are attributable or properly allocable to non-Subpart F Income of the payor. Reflecting budget concerns in recent years, this provision has been repeatedly adopted for one or two years, each time taking effect retroactively on the first day of the year of enactment.

There is also an exclusion for certain income of a C.F.C. derived in the active conduct of banking or financing business ("Active Financing Income"). The exception from Subpart F for Active Financing Income now applies to taxable years of foreign corporations starting before January 1, 2015. Again, this exception has been enacted several times, each time for one or two years, often toward the end of a calendar year with retroactive effect.

Other exclusions from Foreign Personal Holding Company Income include (i) exceptions for dividends and interest received by a C.F.C. from a related corporation organized and operating in the same foreign country as the C.F.C. and (ii) exceptions for rents and royalties received by a C.F.C. from a related corporation for the use of property within the country in which the C.F.C. is organized. These exclusions do not apply to the extent that the payments reduce the Subpart F Income of the payor.

An exception from Foreign Base Company Income and Subpart F Insurance Income may apply for any item of income received by a C.F.C., if the taxpayer establishes that the income was subject to an effective foreign income tax rate greater than 90% of the maximum U.S. corporate income tax rate. At today's corporate rates, the effective foreign tax rate must exceed 31.5%.

Exclusion of Previously Taxed Earnings and Profits

A U.S. Shareholder of a C.F.C. may exclude actual distributions of earnings and profits from the C.F.C. that were previously included in its income under Subpart F. Any income inclusion under Code §956 resulting from an investment in U.S. property may cause a subsequent distribution to be excluded from income. The inclusion in income results in a previously taxed earnings account for the C.F.C., and dividends are allocated to those earnings before being allocated to undistributed earnings.

Basis Adjustments

In general, a U.S. Shareholder of a C.F.C. receives a basis increase with respect to its stock in the C.F.C. equal to the amount of the C.F.C.'s earnings that have been included in income and not distributed. When dividends are received and allocated to previously taxed earnings, the U.S. Shareholder reduces its basis in the shares of the C.F.C. This eliminates a double inclusion of income under Subpart F and gain from the sale of shares.

Rules Applicable to P.F.I.C.'s

A P.F.I.C. is generally defined as any foreign corporation if 75% or more of its gross income for the taxable year consists of passive income or 50% or more of its assets produce, or are held for the production of, passive income.

Alternative sets of income inclusion rules apply to U.S. persons that are shareholders in a P.F.I.C. These rules are not triggered by any specific ownership percentage in the P.F.I.C., and a 1% shareholder is treated the same as a 10% shareholder.

One set of rules applies to P.F.I.C.'s that are qualified electing funds, under which electing U.S. shareholders currently include in gross income their respective shares of the earnings of the P.F.I.C., with a separate election to defer payment of tax, subject to an interest charge.

A second set of rules applies to P.F.I.C.'s that are not qualified electing funds, under which U.S. shareholders pay tax on certain income or gain realized through the company, plus an interest charge that is attributable to the value of deferral. This is computed based on the holding period for the P.F.I.C. shares, rather than by reference to the years in which income is realized by the P.F.I.C.

A third set of rules applies to P.F.I.C. stock that is marketable. U.S. investors may elect to currently take into account as income or loss the difference between the fair market value of the stock as of the close of the taxable year and their adjusted basis in such stock (subject to certain limitations), often referred to as "marking to market."

Coordination of Anti-Deferral Rules

Rules for coordination among the anti-deferral regimes are provided to prevent U.S. persons from being subject to U.S. tax on the same item of income under multiple regimes. For example, a corporation generally is not treated as a P.F.I.C. with respect to a particular shareholder if the corporation is also a C.F.C. and the shareholder is a U.S. Shareholder.

Foreign Tax Credit

U.S. citizens, resident individuals, and domestic corporations are allowed to claim credit for foreign income taxes that are paid or accrued. In addition, a domestic corporation that owns at least 10% of the voting stock of a foreign corporation is allowed a deemed-paid credit for foreign income taxes paid by the foreign corporation. It applies to tax that is deemed to have been paid when the related income is distributed as a dividend, or that is otherwise included in the domestic corporation's income under the anti-deferral rules.

The foreign tax credit is generally limited to a taxpayer's U.S. tax liability on its foreign source taxable income, determined under U.S. tax accounting principles. This is known as the foreign tax credit limitation. It is intended to ensure that the credit mitigates double taxation of foreign-source income without offsetting U.S. tax on U.S.-source income. The limit is computed for each year by multiplying a taxpayer's total U.S. tax liability by the ratio of their foreign-source taxable income to total taxable income. For a given year, if the total amount of foreign income taxes paid and deemed paid exceeds the taxpayer's foreign tax credit limitation, the taxpayer may carry back the excess foreign taxes to the previous year or carry forward the excess taxes to one of the succeeding ten years.

The computation of the foreign tax credit limitation requires a taxpayer to determine the amount of its taxable income from foreign sources in each of two limitation categories. It does this by allocating and apportioning deductions between U.S.-source gross income and foreign-source gross income in each limitation category. In general, deductions are allocated and apportioned to the gross income to which the deductions factually relate. However, subject to certain exceptions, deductions for interest expense and research and experimental expenses are apportioned based on taxpayer ratios. For interest expense, it is the ratio of the corporation's foreign or domestic assets to its worldwide assets. For research and experimental expenses, it is the ratio of sales or gross income. All members of an affiliated group of corporations are generally treated as a single corporation for purposes of determining the apportionment ratios.

The term "affiliated group" is determined, generally, by reference to the rules for determining whether corporations are eligible to file consolidated returns. These rules exclude foreign corporations from an affiliated group, except that beginning January 1, 2021, the interest expense of the members of the U.S.-affiliated group may be computed on a worldwide-group basis. As a result, interest expenses of foreign members of a U.S.-affiliated group are taken into account in determining whether a portion of the interest expense of the domestic members of the group must be allocated to foreign-source income. An allocation to foreign-source income generally is required only if, in broad terms, the domestic members of the group are more highly leveraged than the entire worldwide group. The new rules are generally expected to reduce the amount of the U.S. group's interest expense that is allocated to foreign-source income.

The foreign tax credit limitation is applied separately to passive basket income and general basket income. Passive basket income includes interest and dividend income. General basket income includes all other income. Having said that, a special rule applies to certain financial services entities. For these entities, passive income is treated as general category income if it is earned by a qualifying financial services entity. Passive income is also treated as general category income if it is taxed at an effective rate that exceeds the highest rate for individuals and corporations.

When the U.S. taxpayer is a U.S. Shareholder of a C.F.C., dividends, Subpart F inclusions, interest, rents, and royalties from the C.F.C. are assigned to a category by reference to the category of income out of which the dividends or other payments were made. Dividends received by a 10% corporate shareholder of a foreign corporation that is not a C.F.C. are also categorized on a look-through basis.

Finally, a taxpayer's ability to claim a foreign tax credit may be limited by a matching rule under which the credit for foreign income taxes is not allowed prior to the time the foreign-source income is taxed in the U.S.

COMPETITIVENESS OF THE U.S. TAX SYSTEM

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Corporate Tax Rate
Foreign Investment
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INTRODUCTION

U.S. policymakers are often concerned with promoting economic growth and the general economic wellbeing of the U.S. population, both of which are influenced significantly by the level of investment and employment in the United States. The meaning of "competitiveness" in U.S. tax policy discussions is broad but generally reflects these policy concerns. The competitiveness of the U.S. tax system refers in large part to how effectively it promotes domestic investment and employment, and U.S. economic growth in general.

Domestic investment and employment arises from a number of sources, including the activities of U.S. multinationals and other U.S. businesses as well as foreign multinationals. In turn, their investment decisions in the United States may be based on a number of factors, including:

- The quality of the U.S. workforce and the cost of labor;
- Expected sales growth both in the United States and abroad (*i.e.*, the demand for their goods and services);
- The location of both customers and input suppliers;
- Taxes; and
- The economic benefits of locating activities in particular areas, such as a geographic region (*e.g.*, Silicon Valley), because, for example, of existing research networks and proximity to universities.

In the cross-border context, concerns about the competitiveness of the U.S. tax system have centered on policy objectives that include: (i) fostering the growth of U.S. multinationals abroad, (ii) encouraging domestic investment by U.S. and foreign businesses, and (iii) promoting U.S. ownership, as opposed to foreign ownership, of U.S. and foreign assets. These particular policy objectives may be important to policymakers for a number of economic reasons, described below.

FOSTERING THE GROWTH OF U.S. MULTINATIONALS ABROAD

When U.S. multinationals grow overseas, as measured by increased sales abroad, greater domestic investment and employment may result. For example, a company may increase employment at a manufacturing plant or build new facilities if sales of its U.S.-made goods increase abroad. Likewise, an opportunity to expand into a new foreign market may increase the resources that a company puts into its

U.S.-based marketing and management activities as it aims to gain a foothold in that market. To the extent that a U.S. company relies on its domestic operations to service foreign markets, increased sales overseas should increase domestic investment and employment. In addition, an increase in earnings may increase the value of the U.S. company, the benefits of which could accrue primarily to U.S. shareholders given the documented "home bias" in portfolio investments (*i.e.*, the disproportionate share of local equities that investors hold in their portfolio relative to what theories of the benefits of international diversification would predict).

"Higher levels of domestic investment by U.S. and foreign businesses may contribute to U.S. economic growth and job creation."

However, if growth of U.S. sales abroad is accompanied by increased foreign investment and employment, that may in turn result in lower U.S. investment and employment. For example, a company may decide to move its U.S.-based manufacturing and marketing operations overseas, which reduces domestic investment and employment. However, it may also be the case that foreign investment and employment complements domestic investment and employment. For example, the successful expansion of a company's overseas operations may provide the company with funds to make more domestic investments and increase its domestic workforce.

The evidence has been inconclusive on whether foreign investment and employment complements or substitutes for domestic investment and employment. One study has found that expansion of a company's domestic economic activity is associated with expansion in the activity of its foreign affiliates. However, this can occur if a company develops a new product and expands its sales force both in the United States and overseas. In that case, domestic investment and employment growth coincides with, but is not caused by, foreign investment and employment growth. Another study finds that, on average, increases in domestic employment by U.S. multinationals are associated with increases in employment of their foreign affiliates.

However, this result holds only for affiliates in high-income countries. For affiliates in low-income countries, where labor costs may be significantly lower than in the United States, the authors found that foreign employment growth is associated with reductions in U.S. employment.

ENCOURAGING DOMESTIC INVESTMENT BY U.S. FOREIGN BUSINESSES

Higher levels of domestic investment by U.S. and foreign businesses may contribute to U.S. economic growth and job creation. For example, when a U.S. business makes a new investment, such as constructing a new factory or research facility, it may need to hire workers as part of the investment. These investments may also increase the productivity of the operations of the U.S. business, which may promote overall economic growth in the United States and potentially raise wages (to the extent that workers' wages rise as their productivity rises). These same economic effects are not restricted to domestic investments by U.S. businesses and could be brought about by domestic investments made by foreign businesses.

PROMOTING U.S. OWNERSHIP OF U.S. AND FOREIGN ASSETS

Some policymakers may prefer that ownership of U.S. and foreign assets should be held by U.S. persons instead of foreign persons. With regard to foreign assets, U.S. ownership may confer a number of benefits on the U.S. economy. Foreign assets may serve as a platform for overseas expansion and growth, potentially increasing domestic employment and investment. In addition, when a U.S. company acquires a foreign company, it may also be acquiring intangible property, such as intellectual property and managerial know-how. The intangible property may complement existing U.S. operations and enhance effectiveness. Moreover, income generated from the asset will be part of the U.S. income tax base rather than the income tax base of another country.

Relative to situations involving U.S. ownership of a foreign asset, it is less clear how, as a general matter, U.S. ownership of a U.S. asset benefits the U.S. economy more than foreign ownership of a U.S. asset. For example, when a foreign company acquires a U.S. company, the headquarters operations of the U.S. company may move outside the United States. This may result in the direct loss of employment in the United States as well as some of the local economic benefits that accompany headquarters operations, including involvement in philanthropic activities. Not mentioned in the J.C.T. Report is the effect of cash flows from dividends to domestic shareholders. Although U.S. persons can own American Depository Receipts relating to a foreign publicly traded entity, the cash flow to U.S. investors and U.S. tax exempt entities may be more pronounced when the owner of the U.S. assets is a U.S.-based multinational group rather than a foreign counterpart. This factor is curiously missing in the J.C.T. Report.

"Not mentioned in the J.C.T. Report is the effect of cash flows from dividends to domestic shareholders."

When a foreign company starts a new venture in the United States by making new investments ("greenfield investments") instead of acquiring an existing company, the U.S. economy may benefit through increased employment and investment. This positive economic impact may come at the expense of U.S. businesses, though. For example, the foreign company's U.S. venture may be competing directly with a U.S. company for control of a market for a particular product. If the foreign company's U.S. venture succeeds in controlling the market at the expense of its U.S.-based competitor, net investment and employment in the United States may still increase, but dividend tax, net investment income tax, and future taxable pension payments funded by dividends may be reduced. No mention of these reductions is made in the J.C.T. Report. In addition, no inquiry was made regarding the carry-on effect for the U.S. economy when a business is sold by U.S. investors. In principle, this includes additional investments in new direct and portfolio investments in the U.S.

In both of the foregoing examples, a foreign-headquartered company owns a U.S. asset that could have been owned by a U.S.-headquartered company. However, while new foreign investment has a positive impact on the U.S. economy, the economic impact of a foreign company acquiring an existing U.S. company and moving its headquarters overseas is negative. These examples, and the U.S. economic impact described, are hypothetical, but they illustrate that the distinction between foreign ownership of an existing versus a new U.S. asset is important for economic analysis. However, there is little empirical evidence on the extent to which these hypothetical examples reflect existing investment patterns, and if so, whether, on balance, U.S. ownership of U.S. assets provides greater economic benefits than foreign ownership of U.S. assets.

General consideration should be given to whether a U.S. asset is more productive under foreign ownership than U.S. ownership for purely economic reasons. A foreign company, for example, may have a stronger overseas presence (in the relevant markets) than prospective U.S. acquirers of a U.S. company, and may facilitate the global expansion of the U.S. company more effectively. However, that would seem to be more likely if the foreign markets are not already served with a product that is comparable to the product manufactured in the U.S. The economic case for promoting U.S. ownership of the U.S. company in this situation is unclear. However, if the U.S. company is more productive under U.S. ownership, but for tax reasons is more valuable in the hands of a foreign owner, there may be a stronger case for designing tax rules to promote U.S. ownership of these assets. Whether the latter case exists is open for debate.

COMPETITIVENESS OF THE U.S. TAX SYSTEM IN A GLOBAL ECONOMY

The United States is part of a global economy in which many governments adopt policies to attract investment and promote the overseas growth of their multinationals. Over the past decade, there have been declines in statutory corporate income tax rates and adoption of tax rules that exempt active foreign-source income from home-country taxation. To illustrate, the corporate tax rate in the U.K. is 21% and is scheduled to be reduced to 20%. Dividends from foreign subsidiaries are promoted through a 100% dividends received deduction or exemption. Compare this to the situation of a corporation based in the U.S., where the topline corporate tax rate is 35% at the Federal level with State and local taxes added on top (although deductible in computing Federal taxable income). In addition, dividends from foreign subsidiaries are fully taxed but subject to a foreign tax credit. This policy encourages publicly traded corporations to permanently invest profits outside the U.S. and, therefore, to use funds to acquire additional property, plants, and equipment abroad. This permanent investment enhances financial statement performance because deferred U.S. tax is viewed to be nil. In addition, preferential tax regimes for income derived from intellectual property. have been widely adopted, causing the O.E.C.D. to focus on patent box companies as a form of base erosion and profit shifting.

Decline in Statutory Corporate Income Tax Rates and the Adoption of Exemption Systems

Decline in Statutory Corporate Income Tax Rates

The gradual decline in statutory corporate income tax rates around the world and the emergence of the U.S. as the most highly taxed country is illustrated by the following table:

> ***"In 2014, the United States had the highest combined statutory corporate income tax rate (39.1%) among O.E.C.D. countries."***

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Australia	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Austria	34.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
Belgium	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0
Canada	34.4	34.2	33.9	34.0	31.4	31.0	29.4	27.6	26.1	26.3	26.3
Chile	17.0	17.0	17.0	17.0	17.0	17.0	17.0	20.0	20.0	20.0	20.0
Czech Republic	28.0	26.0	24.0	24.0	21.0	20.0	19.0	19.0	19.0	19.0	19.0
Denmark	30.0	28.0	28.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	24.5
Estonia	26.0	24.0	23.0	22.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0
Finland	29.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	24.5	24.5	20.0
France	35.4	35.0	34.4	34.4	34.4	34.4	34.4	34.4	34.4	34.4	34.4
Germany	38.9	38.9	38.9	38.9	30.2	30.2	30.2	30.2	30.2	30.2	30.2
Greece	35.0	32.0	29.0	25.0	25.0	25.0	24.0	20.0	20.0	26.0	26.0
Hungary	16.0	16.0	17.3	20.0	20.0	20.0	19.0	19.0	19.0	19.0	19.0
Iceland	18.0	18.0	18.0	18.0	15.0	15.0	18.0	20.0	20.0	20.0	20.0
Ireland	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5
Israel	35.0	34.0	31.0	29.0	27.0	26.0	25.0	24.0	25.0	25.0	26.5
Italy	33.0	33.0	33.0	33.0	27.5	27.5	27.5	27.5	27.5	27.5	27.5
Japan	39.5	39.5	39.5	39.5	39.5	39.5	39.5	39.5	39.5	37.0	37.0
Korea	29.7	27.5	27.5	27.5	27.5	24.2	24.2	24.2	24.2	24.2	24.2
Luxembourg	30.4	30.4	29.6	29.6	29.6	28.6	28.6	28.8	28.8	29.2	29.2
Mexico	33.0	30.0	29.0	28.0	28.0	28.0	30.0	30.0	30.0	30.0	30.0
Netherlands	34.5	31.5	29.6	25.5	25.5	25.5	25.5	25.0	25.0	25.0	25.0
New Zealand	33.0	33.0	33.0	33.0	30.0	30.0	30.0	28.0	28.0	28.0	28.0
Norway	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	27.0
Poland	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0
Portugal	27.5	27.5	27.5	26.5	26.5	26.5	26.5	28.5	31.5	31.5	31.5
Slovak Republic	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	23.0	22.0
Slovenia	25.0	25.0	25.0	23.0	22.0	21.0	20.0	20.0	20.0	17.0	17.0
Spain	35.0	35.0	35.0	32.5	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Sweden	28.0	28.0	28.0	28.0	28.0	26.3	26.3	26.3	26.3	22.0	22.0
Switzerland	24.1	21.3	21.3	21.3	21.2	21.2	21.2	21.2	21.2	21.2	21.1
Turkey	33.0	30.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
United Kingdom	30.0	30.0	30.0	30.0	28.0	28.0	28.0	26.0	24.0	23.0	21.0
United States	39.3	39.3	39.3	39.3	39.3	39.1	39.2	29.2	39.1	39.1	39.1
O.E.C.D. Median	**30.0**	**29.0**	**28.0**	**27.0**	**26.8**	**26.0**	**25.8**	**25.5**	**25.0**	**25.0**	**25.0**

Source: O.E.C.D. Tax Database.

For each year, the cell corresponding to the country with the highest tax rate is shaded pink, while the cell associated with the country with the lowest tax rate is shaded blue. There has been a steady, downward trend in statutory corporate tax rates in O.E.C.D. countries other than the United States. From 2004 to 2014, the median combined statutory corporate income tax rate fell from 30% to 25%. Moreover, in 2014, the United States had the highest combined statutory corporate income tax rate (39.1%) among O.E.C.D. countries, while Ireland had the lowest (12.5%) for active business operations.

Adoption of Exemption Systems

Since 2000, many O.E.C.D. countries have adopted some form of exemption system for the taxation of foreign-source income. According to one report, of the 34 countries that make up the O.E.C.D., 28 have some form of an exemption system compared to 13 at the start of 2000.

Implications for the Competitiveness of the U.S. Tax System

Growth of U.S. Multinationals Abroad

In foreign markets, U.S. corporations may have more limited options for growth than foreign competitors. Consider a U.S. corporation and a foreign corporation that both require an after-tax rate of return of 10% on investments in a given market outside their home country. The market jurisdiction has a tax rate of 20%. If the earnings of the foreign corporation are exempt from home-country tax, this means that it will pursue investments that yield a required pre-tax rate of return of 12.5%. In contrast, the U.S. corporation's required pre-tax rate of return may be greater than 12.5%, even though it can defer paying residual U.S. tax on its earnings, because it cannot reduce the present value of its U.S. residual tax liability below zero in the absence of cross crediting the income, meaning a blending of tax rates among various foreign investments in several countries. Therefore, the U.S. corporation may forego investments – such as expansion of manufacturing facilities or acquisitions of local companies – that it would have pursued if its returns were not subject to U.S. taxation. This may make it more difficult for the U.S. corporation to gain market share relative to the foreign corporation, and also may have an indirectly negative effect on employment and economic growth in the United States, at least to the extent that a U.S. company's success overseas translates into increased domestic investment and employment. However, if the U.S. corporation is able to fully offset the residual U.S. tax liability on its earnings with credits allowed for income taxes paid in another jurisdiction, it would not be at a competitive tax disadvantage relative to the foreign corporation. Moreover, the ability of a U.S. corporation to defer paying residual U.S. tax on its earnings may limit its competitive tax disadvantage because its cash flow would not be immediately reduced by its U.S. tax liability. However, the profits must remain abroad – outside the U.S. economy – for this benefit to be realized, leading one to question whether that is prudent economic policy.

Domestic Investment by U.S. and Foreign Businesses

Economics literature has found that the location of foreign direct investment is sensitive to both statutory tax rates and effective marginal tax rates, which is the effective rate of tax on the income generated by the investment, accounting for all features of the tax system such as tax incentives and methods of cost recovery, including depreciation, amortization, depletion, credit, advantageous loan terms, and grants. In a competitive global market for investment, the United States is at a competitive disadvantage even in the presence of certain incentives such as the Code §199 domestic production activities deduction (which yields a tax benefit of three percent for a profitable taxpayer) and accelerated cost recovery methods.

Ownership of Assets

Policymakers may be concerned that the U.S. system of worldwide taxation may put U.S. multinationals at a competitive disadvantage in acquiring operating assets and businesses. It is not difficult to conclude that foreign multinationals have more opportunities to fund growth when dividends from operating companies and profits of foreign branches are exempt from home country tax, all other things being equal.

Intellectual Property or "Patent Box" Regimes

A number of countries make it a priority to promote domestic investment in research and development ("R&D") that generates innovation. Efficiencies attributable to innovation can be an important offset to a low tax rate on the income from an investment in operating assets. The typical path involves the establishment of intellectual property ("I.P.") regimes for companies that engage in innovation activities. These companies are often referred to as "box companies" because innovation technology is ring fenced within the box. These regimes offer preferential tax treatment on income attributable to I.P. Belgium, Cyprus, France, Hungary, Luxembourg, Malta, the Netherlands, Portugal, Spain, and the United Kingdom all have box company legislation in place at this time. Italy and Ireland have announced adoption of similar regimes as part of their annual budgets. The following table illustrates the various regimes.

Country	Qualified I.P.	Nexus Requirement	Benefits
Belgium	Qualifying patents (excludes trademarks, designs, models, or secret recipes or processes)	Requires patent to be developed by Belgian company or acquired patent to be further improved by Belgian company	80% deduction of qualifying gross patent income
Cyprus	Patents, copyrights (including literary works, scientific works, artistic works, films, etc.), trademarks, designs and models	Property must be owned by the Cyprus resident company	80% of royalty income and profit generated from the disposal of qualified property is exempt
France	Patent granted in France, United Kingdom, or European Patent Office or specified European countries or if invention would have been patentable in France (excludes trademarks, design rights and copyrights)	Intellectual property rights must be owned by the French company, must own acquired rights for at least two years	Revenue or gain derived from the qualified property (does not include embedded royalties) taxed at 15%
Hungary	Patents, know-how, trademarks, business names, business secrets and copy	Applies to developed and acquired intellectual property	50% deduction for royalties received from related or third parties for the use of property
Ireland	Patents and property functionally equivalent to patents	Intent to follow O.E.C.D. and E.U. modified nexus approach	
Italy	Patents and property functionally equivalent to patents	Intent to follow O.E.C.D. and E.U. modified nexus approach, must perform research and development activity either directly or in cooperation with universities, must enter into an advanced pricing agreement	Exemption for income sourced from intangible assets, 30% exemption in 2015, 40% exemption in 2016, 50% exemption after 2016

Country	Qualified I.P.	Nexus Requirement	Benefits
Luxembourg	Patents, trademarks, designs, domain names, models and software copyrights	Luxembourg company must be the economic owner of the rights (does not include rights acquired from a related party)	80% tax exemption for net income derived from the use or right to use qualified property
Malta	Patented intellectual property and qualifying copyrights	Must own the rights to the patented intellectual property and receive royalties or similar income	Full tax exemption for qualifying patented inventions and qualifying copyrights
The Netherlands	Worldwide patents and intellectual property arising from research and development activities for which the taxpayer has obtained a declaration from the Dutch government (trademarks, non-technical design rights and literary copyrights are not included)	Dutch company must be the economic owner and bear the risks associated with ownership, development activities must be conducted at the risk of the Dutch company, but research and development is not required to be performed in the Netherlands	5% rate on income from a qualifying intangible, includes embedded royalties if more than 30% of the derived income is attributable to the patent
Spain	Patents, drawings or models, plans, secret formulas or procedures, and rights on information related to industrial, commercial, or scientific experiments	Intellectual property must be created by the resident company and includes other requirements related to the use of the property	Exempts 60% of the net income derived from the qualified property
United Kingdom	Patents granted by the United Kingdom or European Patent Office (excludes trademarks and registered designs) and certain associated intellectual property	Requires legal ownership of the patent, must be developed by a company in the worldwide corporate group, U.K. company must make a significant contribution to developing the patent	10% tax rate on income from patented inventions and certain other innovations

Source: J.C.T. Report

While patents qualify for the benefits of the regime in all of the above countries, some countries offer benefits to non-patented property, including trademarks, copyrights, and business secrets. Some countries only require that the I.P. be owned by the resident company, while others may require that the I.P. be developed or improved by the resident company. The regimes have been an area of focus and scrutiny under the O.E.C.D.'s B.E.P.S. Action Plan. A view exists that I.P. regimes promote unfair tax competition if countries do not require some physical nexus between the location of I.P. ownership and the economic activities that helped produce that property. Of course, abuse is in the eye of the beholder, and the O.E.C.D. view is that the income of a box company is easily placed in a company based in a country with a low tax regime, and for that reason, it may be viewed as abusive unless developmental activities also occurred in that country.

Modified Nexus Approach

Recently, the European Commission and O.E.C.D.'s Forum on Harmful Tax Practices conducted reviews of certain regimes, including I.P. tax regimes. In the case of the O.E.C.D., the review was part of B.E.P.S. Action Plan item 5. The O.E.C.D. report identified that countries shared the goal of aligning the taxation of preferential regime profits with the location of a company's substantial activities in order for it to be eligible for preferential tax treatment. At that time, no consensus existed regarding the approach that would be used to evaluate the substantial activity requirement. One approach was the nexus approach, which evaluates a regime based on whether benefits are conditioned on a link between the performance of R&D activities and the entitlement to benefits. In this approach, the R&D expenses act as a proxy for the amount of activities conducted. The test is based on the proportion of expenditures that demonstrate real value added by the taxpayer. Under this approach, the provision of capital used by another entity would not be a qualifying activity. This should be compared with U.S. domestic R&D credit rules, where R&D performed by a research institute can give rise to a credit claimed by a taxpayer.

In order to reach consensus within the O.E.C.D., the U.K. and Germany proposed a modified nexus approach. This approach has been endorsed by all of the O.E.C.D. and the G20 countries. Existing regimes would be allowed to continue for five years with no new entries into the regime after June 2016. The agreement calls for general acceptance of the modified nexus approach with an addition for an "uplift." The up-lift would allow an additional 30% of qualifying expenses for outsourcing, and I.P. acquisition costs would be included as qualifying expenditures. I.P. assets that could qualify for the preferential regime include patents and functionally equivalent I.P. assets that are legally protected and subject to approval and registration processes, where such processes are relevant. Marketing-related I.P. assets such as trademarks are explicitly excluded.

"The nexus approach, which evaluates a regime based on whether benefits are conditioned on a link between the performance of R&D activities and the entitlement to benefits."

Economic Analysis of I.P. Regimes and Implications for the United States

Promoting domestic investment in R&D is important to U.S. policymakers. While the U.S. tax system subsidizes research activities by offering a credit for certain qualified research expenditures, and allowing such expenditures to be expensed instead of amortized, concern has been expressed that the I.P. regimes mentioned above will attract research activity away from the United States. Some commentators have argued that the United States should adopt a patent box regime to promote investment in R&D through lower tax burdens. The J.C.T. Report challenges this view, commenting that it is not clear that an I.P. regime is more effective than a research credit, which is more targeted in identifying qualified activity. The J.C.T. Report posits that a more generous U.S. research credit may better address the concern that many U.S. policymakers have with patent box regimes. Stated differently, an untargeted regime that broadly lowers taxes does not necessarily result in the creation of I.P. that increases efficiencies in operations. However, there is little empirical research on this particular claim.

Policymakers have also pursued I.P. regimes based on the premise that the location of legal entitlements to I.P. influences where companies make investments related to that I.P. Although there are a number of studies showing that innovation activity often is concentrated in particular locations near universities, there are few studies that examine whether investments related to a particular piece of I.P. are also concentrated in the geographic location where ownership rights are held.

ECONOMIC DISTORTIONS ARISING FROM DEFERRAL

Author
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Tags
Deferral
Foreign Investment
Lockout Effect
Reinvest Foreign Earnings
Repatriate

One of the main policy issues in the Joint Committee on Taxation Report is how deferral of U.S. tax causes economic distortions. U.S. lawmakers are particularly concerned with how deferral influences the initial choice between foreign and domestic investment, the "lockout effect," and repatriating or reinvesting foreign earnings.

The tax system incentivizes U.S. corporations to invest abroad instead of domestically because corporations are able to defer U.S. tax on foreign earnings. The deferral of tax on foreign earnings enables taxpayers to reinvest higher amounts of income. When a U.S. taxpayer invests domestically, the income produced cannot be deferred and is subject to current taxation. Thus, a U.S. corporation will prefer to invest in a foreign country instead of the U.S. because the returns on the U.S. investment are immediately taxed, even if both investments generate the same pre-tax rate of return.

Here is an example. Suppose that a U.S. privately-held corporation that reports income subject to tax in the 35% tax bracket is considering whether to make an investment in an active enterprise in the United States or in an equivalent investment opportunity in a country in which the income tax rate is zero. Because the taxpayer is privately held, financial statement accounting rules that address deferred taxes have limited effect in management decisions except for any loan covenants. Assume the U.S. taxpayer chooses to make the investment in the foreign country through a C.F.C. that earns $100 of active income and the U.S. taxpayer defers tax on that income for five years by reinvesting the income in the C.F.C. Assume further that the C.F.C. can invest the money and earn a 10% return per year, and the income earned is not subject to foreign tax or current U.S. taxation under Subpart F. After five years, the taxpayer will have earned $161.05 of income and will pay tax of $56.37 on repatriation, for an after-tax income of $104.68.

If, instead, the U.S. entity pursues the equivalent investment opportunity in the United States, income from such an investment will not be eligible for deferral. When the taxpayer receives $100 in income today, it pays Federal tax of $35, and has only $65 to reinvest. The taxpayer invests that amount at an after-tax rate of 6.5%. At the end of five years, this taxpayer has an after-tax income of $89.06, in comparison to the foreign investment option which generates an after-tax income of $104.68. The result is that the foreign investment option to defer tax on the income for five years leaves the taxpayer with $15.62 more in profits than the domestic investment option, an increased return of 17.5%. Extrapolate this example to an active income of $10 million, and the difference in return over five years is $1,562,000. Is it any wonder that the owners and managers would be influenced by U.S. tax policy?

Deferral of U.S. tax may cause a "lockout effect." The lockout effect is of concern to publicly traded companies that must report deferred U.S. taxes as an expense in the current year. The lockout effect disappears if repatriation of overseas earnings has no tax consequence, as would be the case if foreign earnings were permanently invested abroad. This means that the company has a policy of reinvesting the earnings abroad so that there is no realistic possibility that the deferred tax will be paid as business operations continue. The effect of this accounting policy is that dividends will not be paid. In recent times, the lockout effect was illustrated when Apple borrowed funds to pay dividends to shareholders rather than tap into the profits of its offshore subsidiaries. The need to borrow illustrated that Apple's foreign earnings were locked out of the U.S. For companies that are not at the level of Apple, the lockout effect means that U.S. corporations must increase their debt burden in order to invest in U.S. assets or pay dividends.

As the foregoing example illustrates, the lockout effect results in economic distortions. This impact could be diminished by reducing the tax rate on repatriatied foreign earnings. However, if, as the Administration proposes, the reduced rate remains above 15%, it is not likely that companies with publicly-traded debt will repatriate earnings if the effect is a provision for deferred tax at a rate of 15% or higher on unrepatriated earnings for financial statement purposes. Capital markets in the U.S. would likely lose significant value.

SHIFTING INCOME AND BUSINESS OPERATIONS

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Tags
Anti-Deferral
B.E.P.S.
Deductions
Income Shifting
Intellectual Property
License
Royalties
Subpart F

INTRODUCTION

Multinational groups ("M.N.G.'s") engage in foreign direct investment as they acquire or create assets abroad to manufacture or sell the corporation's goods and services. There are many business reasons to make outbound foreign direct investments. Building a plant abroad may be the most cost efficient way for a U.S.-based M.N.G. to gain access to a foreign market. Trade barriers or transportation costs could make it prohibitively costly to serve the foreign market via direct export from a U.S. location. Foreign direct investment may put the U.S.-based M.N.G. physically closer to its customers, allowing better customer service and providing a better understanding of the foreign market. A U.S. multinational corporation may make an outbound foreign direct investment to lower operating costs by exploiting less expensive, or more skilled, foreign labor and less expensive access to raw materials or components from suppliers, or to permit operation in a less burdensome regulatory environment. Foreign direct investment may provide access to technology developed abroad.

Another factor that may motivate foreign direct investment is the tax burden placed upon a U.S.-based M.N.G.'s. The phrase "to shift income" is used in the J.C.T. Report to refer to the broad range of tax-planning techniques that minimize tax liability by migrating income or items of income from a high-tax jurisdiction to a jurisdiction with a low- or zero-tax rate. Such migration may be achieved through the restructuring of a business and its supply chain, the transfer or sharing of ownership rights to intangible property ("I.P."), and use of the asymmetries between U.S. law and that of another jurisdiction in order to avoid income recognition under Subpart F and ensure deferral.

VALUE CHAIN PLANNING

While it is generally not possible to avoid high-tax jurisdictions entirely, an integrated value chain may be structured in a way that achieves both business and tax objectives. These structures often follow what has come to be known as the principal model, which limits the functions and contractual risk of M.N.G. members in high-tax countries allowing the profit attributable to risk-taking and high value functions to be allocated to a member in a low-tax country. To illustrate, a group member in a low-tax country would act as principal. It would own I.P. rights and would retain the contractual responsibility for high value functions associated with that property, such as the continued development of I.P., as well as the general management and control of business operations. In comparison, lower value functions, such as contract manufacturing or limited risk distributor functions, would be performed in locations dictated by non-tax business needs or historical reasons. Examples include proximity to suppliers and ultimate customers and an experienced workforce.

Those functions would be performed by a related contract manufacturer or other limited-risk contractor that recognizes positive taxable income limited to a routine return reflecting the absence entrepreneurial risk.

In the past, the O.E.C.D. recognized the importance of risk-taking and the contribution efficient value chain structures made to lower the barrier to entry in new markets. However, there exist concerns that some allocations of risk may be mere formalities. This underlies several action items within the ongoing Base Erosion and Profit Shifting Initiative ("B.E.P.S.").

"A cost-sharing arrangement is a cross-border transfer through the sharing of I.P. rights....Significant controversy exists regarding the 'buy-in'...and the indirect costs that must be shared."

Commentators have expressed concern that traditional transfer pricing principles are ignored by the O.E.C.D. recommendations, which, if adopted, would make it difficult for a corporation to know whether its structures and risk allocations will continue to be respected.

Evidence exists that there is increasing awareness of these concerns, which may lead to more cautious tax-planning. This can play out in two behavioral changes. One is the avoidance of the principal model where possible. The other is the creation of substance in the principal model so that risks and functions are accompanied by head count and facilities. Both are evidence of a "good citizen" approach, but the latter leads to loss of high-value functions now performed in the United States on a contract basis by a related party.

EXPLOITATION OF I.P. RIGHTS

The taxation of income attributable to I.P. is a particularly difficult area for policymakers. The location of I.P. and related profit is highly sensitive to tax rates and may account for a significant share of shifting profit to low-tax jurisdictions.

A U.S. person may transfer I.P. or a right to use the property to a related foreign person in one of four ways: (i) an outright transfer of all substantial rights in the I.P., either by sale or through a non-recognition transaction such as a tax-free capital contribution; (ii) the provision of services by a member of the U.S. M.N.G. where the use of the I.P. enhances the value of services; (iii) a license of the I.P.; and (iv) a qualified cost-sharing arrangement.

All licenses or sales of I.P., and provision of services that use I.P., are generally required to be conducted on an arm's length basis. A cost-sharing arrangement is a cross-border transfer through the sharing of I.P. rights. Again, it must be carried out on an arm's length basis and significant controversy exists regarding the "buy-in," which is an upfront cost for the right to share, and the indirect costs that must be shared. Direct costs are not controversial, but equity-based compensation is a flashpoint at the present time. As a result of the arrangement, the foreign affiliate owns some or all of the rights to the new technology developed under the arrangement for use within its designated geographic area of operation.

If a transfer of I.P. to a foreign affiliate occurs in connection with certain corporate transactions, the transferor must recognize imputed income as if it sold the intangible for payments that are contingent on the use, productivity, or disposition of the transferred property. The payments continue over the useful life of the property or its period of ownership, up to 20 years.

MOVING DEDUCTIONS INTO THE U.S. AS A TAX PLANNING STRATEGY

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Tags
Corporate Taxation
Deductions
Tax Credits

The J.C.T. Report recognizes that, for multinational taxpayers engaged in cross-border transactions, the ability to claim deductions when determining Federal income tax liability is a fundamental component of international tax planning strategy.[1]

The U.S. has the highest combined Federal, state, and local corporate tax rate – a fact that incenti*vize*s multinational corporations to generate higher U.S. tax deductions in order to minimize the taxable base. The maximum U.S. Federal corporate tax rate is 35%, and the addition of state and local taxes can push the effective tax rate even higher. In New York City, for example, the combined effective tax rate can climb to approximately 45%. In contrast, the U.K. corporate tax rate is scheduled to be 20% in 2015. Consequently, a tax deduction in the U.S. is often more valuable than one in a foreign jurisdiction, and planning strategies may be designed to move or "shift" deductions into the U.S.

In light of this situation, the J.C.T. Report focuses on several areas where it may be worth considering legislative action in order to limit the shifting of deductions into the U.S.

MULTINATIONAL ARBITRAGE

Arbitrage between the creation of deductions in the U.S. and the shifting of income to a lower tax jurisdiction outside the U.S. is an erosion of the U.S. tax base. Effectively, this results in the U.S. subsidizing overseas growth and incenti*vizi*ng U.S. investment abroad.

Detailed regulations under Code §861 address allocation and apportionment of deductions and interest. These regulations impact non-U.S. persons in the determination of U.S.-source taxable income. In contrast, U.S. corporations that are taxable on worldwide income are not usually affected by these rules, in the sense that no matter how interest is apportioned or allocated to income baskets, the interest remains deductible to the extent provided by law. The apportionment rules have the greatest effect when determining foreign tax credit ("F.T.C.") limitations. As a result, opportunity remains for U.S. corporations with foreign affiliates to utilize tax planning maneuvers in order to lower their U.S. tax liability, and the J.C.T. Report expresses concern about this.

A U.S. corporation may deduct interest expense incurred in connection with a borrowing to fund operations, but because the money is fungible, it is difficult to

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[1] As a general rule, taxpayers may deduct ordinary and necessary expenses paid or incurred during a taxable year in which they are engaged in carrying on a trade or business in the U.S. Exceptions apply to certain disallowances indicated in the Code.

determine whether the loan is actually used to fund a company's operations or if that money is used for another purpose. A company that borrows for an investment frees up other cash to be used for other purposes. A U.S. multinational corporation may choose to locate its borrowing in the country where the interest expense deduction will produce the highest tax benefit (*i.e.*, the country with the highest tax rate and the fewest restrictions on deductibility), while utilizing those funds in another jurisdiction. The J.C.T. Report notes that:

> The fact that a U.S.-based multinational can claim a current U.S. tax deduction for borrowing to invest in low-taxed countries increases the after-tax return of those investments and may encourage some investments that would not otherwise be made. In this respect, the current U.S. tax system can be viewed as subsidizing overseas growth and investment by U.S.-parented groups.

A U.S. corporation can claim a deduction under Code §174 for expenditures in relation to research and development ("R&D") activities. Where that R&D results in innovative techniques, processes, or formulas, U.S. corporations will sometimes transfer valuable intellectual property ("I.P."), or rights to use the I.P., to foreign affiliates, thereby allowing some or all of the profit from the I.P. to accumulate in low-tax environments offshore. The combination of a high U.S. tax rate that encourages placement of deductions in a U.S. entity and the deferral of earnings offshore promotes a scenario in which taxpayers are incenti*vize*d to distort the location of income and expenses. The distortion is magnified if inadequate compensation is received by the U.S. member of an M.N.G. in the form of royalties and other payments.

EARNINGS STRIPPING

A foreign parent with a U.S. corporation may reduce its U.S. taxable income by making deductible payments to the foreign parent or affiliates; these include interest, royalties, management or service fees, rents, and reinsurance premiums. Taking tax deductions in the U.S. in connection with borrowings from foreign affiliates so that U.S. tax is reduced for the payor without tax being imposed on the recipient is known as "earnings stripping." The result arises because income tax treaties usually reduce or eliminate the statutory 30% withholding tax on payments of fixed and determinable, annual and periodic income to foreign entities.

Use of Debt Rather Than Equity

There are tax advantages to financing a business through a combination of debt and equity. Debt financing allows a business to raise funds at a lower cost, which therefore allows for a lower cost on the return to debt investors.

A U.S. corporation can claim an interest deduction, but it cannot claim a deduction for dividends paid to its shareholders. The debt principal may be repaid on a tax-fee basis. In contrast, distributions to shareholders that are treated as dividend distributions are subject to a 30% withholding tax and earnings must be distributed before capital is repaid. Tax treaties historically provide better treatment for payments of interest rather than payments of dividends. Most entirely eliminate withholding tax on interest. In comparison, with several recent exceptions, the withholding tax on dividends is lowered to 5% or 15%.

In general, earnings stripping provides a net tax benefit only to the extent that the foreign recipient of the income is subject to a lower amount of foreign tax on such income than the net value of the U.S. tax deduction applicable to the payment, *i.e.*, the amount of the U.S. deduction times the applicable U.S. tax rate, less the U.S. withholding tax levied at a percentage provided under the relevant income tax treaty. Such may be the case if the country of the income recipient provides a low general corporate tax rate. The U.K.-U.S. Income Tax Treaty is one example, in light of its general corporate tax rate of 20%. Alternatively, the recipient may benefit from certain tax characteristics, such as a net operating loss, excess credits, or an anti-abuse rule that treats the interest payment as a tax-free dividend.

Code §163(j) was enacted to restrict this type of conduct. A cap is placed on deductions claimed for related-party interest if (i) a U.S. debtor corporation pays interest expenses to a related foreign person that is not subject to a 30% withholding tax, (ii) the debt to equity ratio of the U.S. debtor corporation exceeds 1.5 to 1, and (iii) the corporation has excess interest expense, which broadly means that e interest expense exceeds 50% of the corporation's E.B.I.T.D.A., adjusted for certain items that are tax related. If these conditions apply, then the interest expense deduction on payments to related lenders will be deferred so that the cap of 50% of adjusted E.B.I.T.D.A. is not breached. Any disallowed amount will be deferred until the succeeding year, when it is again subject to these limitations.

The prevalence of earnings stripping is not entirely clear. One Treasury Report concluded that strong evidence indicated that inverted corporations were stripping earnings out of U.S. operations and, consequently, that Code §163(j) was ineffective. The results for other foreign-controlled domestic corporations were not conclusive.

Royalties and Other Deductible Payments

Apart from the use of debt, the potential for earnings stripping also exists for transactions involving the payment of other deductible amounts, such as royalties, management or service fees, rents, reinsurance premiums, and similar types of payments to related foreign entities. Code §482 requires that the fees being charged reflect an arm's length price. However, special earnings stripping rules do not currently exist for these transactions.

As a result, a U.S. corporation may enter into a licensing or distribution agreement with a foreign related party in exchange for royalty payments. The royalty payments have the effect of eroding the U.S. tax base. Alternatively, the U.S. corporation may transfer performance or other risks to a foreign related party in exchange for service or similar fees, leaving a small profit margin in the U.S. that reflects the local market distribution activities. The J.C.T. Report observes that:

> As opportunities for stripping earnings based on interest payments are exhausted, taxpayers may increasingly find it attractive to strip earnings through other means. Although the generation of earnings stripping payments other than interest, such as royalties, may require a real movement of tangible or intangible assets or a change in business operations of the corporation, firms may engage in this tax planning to improve the after-tax return on investment.

Thus, the J.C.T. suggests possible legislative action, such as the addition of earnings stripping rules dealing with non-interest payments.

CONCLUSION

"The J.C.T. Report considers a several legislative solutions that may be used to curtail excessive tax deductions taken by multinational businesses."

The J.C.T. Report considers a several legislative solutions that may be used to curtail excessive tax deductions taken by multinational businesses. However, the possible expansion of earnings stripping rules, and other suggested techniques, may serve only to increase the complexity of taxpayer planning and to create an added burden for the I.R.S. at the time it examines the tax return of a U.S. member of the M.N.G. While such changes may produce higher effective tax rates for multinational corporations, any Congressional action should be approached with care, due to concerns that aggressive action may inhibit U.S. competitiveness in the global economy and ultimately prove to be detrimental to the preservation of a solid U.S. tax base.

"HELEN OF TROY" INVERSIONS CONTINUE

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Tags
Cross-Border Investment
Foreign Corporation
Inversions
U.S. Parent Group

To the extent that the U.S. tax rules impose a greater burden on a domestic multinational corporation than on a similarly situated foreign multinational corporation, the domestic multinational company may have an incentive to undertake a restructuring, merger, or acquisition that has the consequence of replacing the domestic parent company of the multinational group with a foreign parent company. This type of transaction, in which a foreign corporation replaces a domestic corporation as the parent company of a multinational group, has been commonly referred to as an inversion.

Helen of Troy was a publicly traded cosmetic company that reorganized and inverted into a Bermuda company in 1993. This case was highly publicized; the I.R.S. responded by issuing Notice 94-46 (1994-1 C.B. 356), which announced some modifications to stop restructuring "for tax-motivated purposes." The inversion of Helen of Troy reflected a convergence of several favorable factors. The company had a net operating loss shielding it from tax on required gain recognition. Its share price was down. A large proportion of its shareholders were either foreign investors or tax-exempt entities, neither of which were taxable in the event the conversion resulted in a gain.

Since the Notice was issued, many changes have been made or suggested to impede corporate inversions, but the solution has not been found. In 2004, Code §7874 was enacted with the intent of stopping inversions. It created a test whereby a foreign corporation could be treated as a U.S. corporation if 80% of its stock is owned by former shareholders of the domestic target. The Administration has proposed broadening the scope of Code §7874 by reducing the 80% test to a greater than 50% test.

Legislation introduced by Representative Sander Levin and Senator Carl Levin in 2014 is similar to the President's proposal. Their bill would reduce the current 80% test to a greater than 50% threshold. The bill also contains a provision that would bar companies from shifting tax residency offshore if their management, control, and significant business operations remain in the U.S. In addition, the bill would be retroactive to May 8, 2014, if enacted.

POLICY CONCERNS AND POLICY GOALS

Policymakers have devoted much attention to corporate inversions, and many have expressed concern that current policy goals are in conflict with one another and may, therefore, require different responses. One concern expressed by policymakers is that cross-border acquisitions, specifically inversions, may trigger the loss of corporate tax revenue in the U.S. A report[1] by the Congressional Budget Office

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1 Congressional Budget Office, "The Budget and Economic Outlook: 2015 to 2025," January 26, 2015, p. 98.

projects that corporate income tax revenue will decline from 2.3% of gross domestic product ("G.D.P.") in fiscal year 2016 to 1.8% of G.D.P. by fiscal year 2025. According to the report, inversions account for part of this decline.

The goal of protecting U.S. corporate tax revenue is in conflict with many other policy goals, such as the tax policy goal of complete neutrality toward cross border transactions. One of the suggested solutions is to minimize the disparity between a U.S.-parented group and a foreign-parented group by reducing the tax burdens on foreign profits of the U.S.-parented group. This would promote portfolio investment in the U.S and encourage U.S. companies to retain their existing U.S.-parented structures.

"Policymakers do not have concrete evidence as to whether inversions adversely affect economic activity in the U.S. Stricter rules may have an opposite effect than intended on maximizing long term investment and employment in the U.S."

In addition, some argue for stricter rules under Code §7874, believing that either the scope of Code §7874 should be broadened or that the tax benefits of inversions should be eliminated. The goal is to find a way to maximize domestic investment and employment and to discourage U.S. companies from moving their tax domiciles abroad for the purpose of avoiding U.S. Federal taxes.

Senator Orrin Hatch and his colleagues argue for a territorial tax system. Although Senator Hatch acknowledges that a territorial tax is not a "magic elixir," he believes that it is a "first and a very important step." Another possible avenue is to utilize Code §385, which authorizes the I.R.S. to prescribe regulations to determine whether an interest in a corporation is debt or equity. Harvard Professor Stephen Shay has advocated for the I.R.S. to be more aggressive in reclassifying interest payments as dividends, for which no deduction can be claimed.

Policymakers do not have concrete evidence as to whether inversions adversely affect economic activity in the U.S. Stricter rules may have an opposite effect than intended on maximizing long term investment and employment in the U.S.

NOTICE 2014-55

On September 22, 2014, the I.R.S. and Treasury Department issued Notice 2014-55, which was intended to address avoidance of Code §7874 by restricting or eliminating certain tax benefits that come as a result of inversion transactions. Among other things, the notice describes regulations that the Treasury Department and I.R.S. intend to issue, which will include the following activities:

1. Addressing taxpayer planning designed to keep the percentage of the new foreign parent company stock that is held by former owners of the inverted domestic parent company (by reason of owning stock of the domestic parent) below the 80% or 60% threshold;

2. Restricting the tax-free post-inversion use of untaxed foreign subsidiary earnings to make loans to or stock purchases from certain foreign affiliates; and

3. Preventing taxpayers from avoiding U.S. taxation of pre-inversion earnings of foreign subsidiaries by engaging in post-inversion transactions that would end the controlled foreign corporation status of those subsidiaries.

It is not yet clear whether the new rules in Notice 2014-55 will stem the tide of inversions.

CORPORATE MATTERS:
HELP - MY DELAWARE ENTITY HAS BEEN CANCELLED!

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Tags
Cancelled Entity
Certificate of Renewal
Delaware
Failure to File
Revival of Charter

We have received inquiries recently concerning Delaware entities that have been cancelled by the State. This situation is not as bad as it sounds, and after a few simple steps (and a couple of checks), the entity can be reinstated.

HOW DOES IT HAPPEN?

In Delaware, a corporation becomes "void" for failure to file its annual report. The entity becomes "forfeited" if its registered agent resigns and is not replaced. Registered agents typically resign if their annual fee is not paid in a timely manner. The registered agent is required to give 30 days' notice of its intention to resign and will have forwarded to the address of record delinquency notices from the State with respect to unfiled reports.

The certificate of formation of a Delaware limited liability company will be cancelled if the entity fails to pay its annual franchise tax for three consecutive years,[1] or if it fails to replace its registered agent within 30 days.

Before a Delaware corporation becomes void or forfeited or a limited liability company has its certificate of formation cancelled, such entity first ceases to be in "good standing." This occurs as soon as an entity fails to pay certain fees or to file annual reports. While in this status, an entity cannot make any filings with the State or sue in the courts of Delaware. It is also difficult to close any transaction where a good standing certificate is required. This situation may be cured by filing the outstanding reports and paying all outstanding franchise taxes.

REINSTATEMENT

A forfeited Delaware corporation may have its charter restored by filing a Certificate for Renewal and Revival of Charter pursuant to the Delaware General Corporation Law (the "Act").[2] The certificate must include:

- The exact name of the corporation;
- The date of its incorporation under the laws of Delaware;
- The date the corporation was voided;
- The name and address of the corporation's registered agent; and

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1 6 Del C. §18-1108.

2 8 Del C. §312.

- Whether or not the renewal is perpetual.[3]

The filing fee for the certificate is $169.00. Before it can be filed, all franchise taxes, penalties, and interest that were due to the State at the time the entity became void/forfeited must be paid and all applicable annual reports must be filed.

Upon filing of the certificate in accordance with the Act, the corporation will be renewed and revived with the same force and effect as if its certificate of incorporation had not been forfeited or void pursuant to the Act.[4]

With respect to a Delaware limited liability company, the terminology is slightly different, but similar mechanisms are provided to reinstate alternative entities that are cancelled for failure to pay annual taxes or keep a registered agent. To reinstate a Delaware limited liability company, a certificate of revival must be filed[5] and, as with a corporation, all outstanding taxes and penalties must also be paid. The certificate of revival must include:

- The name of the limited liability company;
- The date of filing of its original certificate of formation;
- The address of the limited liability company's registered office in the State of Delaware and the name and address of the limited liability company's registered agent in the State of Delaware; and
- A statement that the certificate of revival is being filed by one or more authorized persons.

CONCLUSION

As can be seen from the timelines mentioned above, a Delaware entity has to be delinquent for an extended period of time before it will be cancelled by the State. Remembering to update local counsel and the entity's registered agent in Delaware along with any changes of address to ensure receipt of all notifications will help avoid cancellation altogether, but reinstatement after cancellation is a relatively straightforward process.

[3] 8 Del C. §312(d).

[4] 8 Del C. §312(e).

[5] 6 Del C. §18-1109(a).

PRE-IMMIGRATION INCOME TAX PLANNING, PART II: COVERED EXPATRIATES

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Tags
Covered Bequests
Covered Expatriate
Covered Gifts
Long-Term Green Card Holder
Long-Term Residency
Pre-Immigration

INTRODUCTION

Continuing on from our previous article concerning pre-immigration planning, this article will explain the tax rules by which an individual seeking to renounce his or her U.S. citizenship or green card status may be affected.

To relinquish U.S. citizenship or a green card, a formal act of relinquishment is required. Therefore, a green card holder who moves outside the U.S. will continue to be treated as a U.S. resident for tax purposes until he or she formally relinquishes green card status or it is rescinded by the government. A U.S. citizen residing outside the U.S. will have to formally relinquish his or her citizenship in order to be removed from the U.S. tax system. As a general rule, termination of U.S. residency becomes effective on the last day of the calendar year in which the status was relinquished. However, under certain circumstances, termination may be effective midyear.

Upon expatriation, should an individual be considered a "covered expatriate," he or she may be subject to an exit tax, and following expatriation, any gifts and bequests made by such an individual may be subject to a succession tax in the case of U.S.-resident recipients.[1]

For planning purposes, U.S. citizens wishing to relinquish their citizenship should determine if they are covered expatriates prior to undertaking any such action. Green card holders wishing to relinquish green card status must first determine if they are treated as long-term residents. If so treated, green card holders should determine if they are covered expatriates under the same tests applicable to U.S. citizens.

COVERED EXPATRIATES

An individual will be treated as a covered expatriate if, at the time of expatriation, he or she meets any one of three tests:

1. The individual's average annual net U.S. income tax liability for the last five years exceeds $160,000[2] (the "Tax Liability Test");
2. The individual has a net worth of $2,000,000 or more (the "Net Worth Test");
3. The individual fails to certify under penalties of perjury, or if required, fails to submit evidence of, compliance with all U.S. Federal tax laws for the last five years.[3]

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[1] As with our prior installment, this article addresses U.S. taxing obligations; departure taxes in other countries are beyond the scope of this article.

[2] Amount applies to 2015 and is adjusted for inflation.

[3] Such certification is made on I.R.S. Form 8854.

For purposes of the Net Worth Test, all types of property are taken into account (*i.e.*, real property, tangible personal property, and intangible property, including, and without limitation, checking accounts and money or other goods in safety deposit boxes). No formal appraisal is required, but the valuation should be made based on the general principals provided in the Internal Revenue Code (the "Code") and Treasury Regulations.

Due to the third test, certain individuals whose net worth is insufficient and their income is also not high enough might nevertheless be treated as covered expatriates. Think of a non-citizen who moved to the U.S. and never reported a foreign financial account he left behind, to name only one type of individual who may face the expatriation tax solely because of the third test. Such individuals may want to consider straightening out their affairs, be it through the I.R.S.'s offshore voluntary program or otherwise, prior to relinquishing residency.

Exceptions Applicable to U.S. Citizens

A child who relinquishes U.S. citizenship will not be treated as a covered expatriate, regardless of the aforementioned tests, provided that (i) citizenship is relinquished before the age of 18½ years, and (ii) he or she has never been a U.S. resident, or having been a U.S. resident, was resident under the substantial presence test for not more than ten taxable years prior to such relinquishment.[4]

A dual citizen, who has been a U.S. resident under the substantial presence test for no more than ten of the last 15 taxable years, will not be subject to the covered expatriate rules if (i) he or she became a dual citizen of the U.S. and another country at birth, (ii) he or she will continue to be a citizen of that foreign country after relinquishing U.S. citizenship, and (iii) that foreign country would tax him or her as a resident.

> Example 1:
>
> Jane was born in Toronto. Her parents are U.S. citizens, and she obtains U.S. citizenship through them. Jane is also a Canadian citizen by birth. She has never resided in the U.S. Jane can expatriate before reaching the age of 18½ years without regard to the covered expatriate tests.
>
> Example 2:
>
> Jane was born in the U.S. to two non-U.S. nationals residing in the U.S. for graduate studies. Jane was born 1995 and is a U.S. citizen by birth. Her parents' country of nationality treats children of nationals as citizens. In 2010, her family moves to her parents' home country, and since that time, Jane was not present in the U.S. for more than 30 days per year. At any point starting in 2015, Jane can relinquish her U.S. citizenship without regard to the covered expatriation tests because as of January 1, 2015, out of the last 15 years she would be a U.S. resident under the presence test for no more than ten years.

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[4] A minor less than 14 years of age cannot renounce U.S. citizenship, and a child's U.S. citizenship cannot be renounced by a parent.

LONG-TERM RESIDENCY

The expatriation rules will apply to non-citizens if they have a green card for long enough to be treated a long-term resident. A green card holder will be treated as a long-term resident if he or she holds a green card for at least eight of the last 15 taxable years. When determining the eight years, any day of holding a green card during a calendar year can cause the entire year to count as a full year. However, some days may be excluded from the count. If the tie-breaker provision of an applicable income tax treaty allocates residency away from the U.S., days during such a period of time will not count toward the eight years if the individual claimed such a treaty benefit.[5]

> Example 3:
>
> John received his green card on December 1, 2010. John will be treated as a long-term resident on January 1, 2017 (less than seven years after the date he received his green card).
>
> Example 4:
>
> John received his green card on December 1, 2010. In March 2014, John moves back to his country of nationality without relinquishing his green card. John files his 2014 tax return as a non-resident under an income tax treaty between the U.S. and his country of nationality. In April 2020, John moves back to the U.S. On January 1, 2023, John will be treated as a long-term resident (more than ten years after the date he received his green card).

"Under current law, covered expatriates are subject to an exit tax, pursuant to which the individual is generally deemed to have sold all property, regardless of location, on the day before he or she relinquished U.S. citizenship or long-term resident status."

TAXATION OF COVERED EXPATRIATES

If an individual is treated as a covered expatriate, the individual must file Form 8854, Initial and Annual Expatriation Statement. This form should be included with the individual's tax return for the year of expatriation. Failure to file (or filing an incorrect form) incurs a $10,000 penalty. The penalty may be waived if it is shown that the failure was due to reasonable cause and not to willful neglect.

Two sets of tax rules govern covered expatriates. The first, which applies directly to the covered expatriate individual, is found in Code §877A. The second, found in Code §2801, applies to the recipient of gifts or bequests made by covered expatriates.

Rules Applicable to the Covered Expatriate

Prior to June 2008, expatriates remained subject to U.S. taxation on various types of U.S.-source income for ten years but otherwise, generally, had no immediate tax consequences. Under current law, covered expatriates are subject to an exit tax, pursuant to which the individual is generally deemed to have sold all property, regardless of location, on the day before he or she relinquished U.S. citizenship

[5] The Code and its regulations provide that claiming such a treaty benefit may affect the immigration status for such an individual. See Code §§877A(g)(5) and 877(e)(2), Treas. Regs. §301.7701(b)-7(a)(1).

or long-term resident status. This set of rules is known as the "mark-to-market" rule. The property subject to this deemed sale is generally any property that would be included in the taxpayer's gross estate for estate tax purposes if the taxpayer died that day as a citizen or resident of the U.S. Gain or loss is recognized on the deemed sale, and tax is due. For 2015, the net gain is reduced (not below zero) by $690,000.[6] Therefore, only covered expatriates that have more than $690,000 of net appreciation in their worldwide property will have an exit tax liability.

For purposes of determining the gain or loss recognized, if property was acquired prior to the individual becoming a U.S. resident, the basis for the deemed sale of that property will be the greater of (i) the fair market value at the time U.S. residency was first established or (ii) the adjusted basis under general U.S. tax principles, subject to an irrevocable election made on a property-by-property basis. Notwithstanding the aforementioned, no step-up in basis is applied to assets that will give rise to U.S. tax regardless of U.S. residency. For example, U.S. real property interests and property used or held for use in connection with the conduct of a U.S. trade or business are subject to U.S. taxation of non-residents and, thus, do not receive a step-up in basis. However, upon actual sale, such assets will only be subject to U.S. tax if the value has increased since the time of the deemed sale because any recognized gain will increase the basis of such property.[7]

Tax basis of the property subject to the exit tax will be adjusted by the amount of gain or loss recognized.

The exit tax applies to real property interest, albeit that the individual would not have escaped the tax net, as non-residents are also taxed on real property situated in the U.S. The exit tax, however, does not apply to deferred compensation items and specified tax-deferred accounts. Such items include, *inter alia*, individual retirement plans, 401(k) plans, and stock options or restricted stock on which an election under Code §83(b) has not been made.

A covered expatriate who has an interest in a deferred compensation item or a specified tax-deferred account must file Form W-8CE, Notice of Expatriation and Waiver of Treaty Benefits, within 30 days of expatriation or on the day prior to a distribution, if earlier, to provide the payor with notice that the individual is a covered expatriate and thereby advise the payor of its withholding tax obligation.

A covered expatriate may elect, on a property-by-property basis, to defer the payment of tax due upon the deemed sale at expatriation until the year in which the asset is actually sold. However, the deferred tax will be subject to interest applicable to underpayments of tax, and the expatriate must (i) irrevocably waive any treaty benefits with respect to the collection of tax on such property, (ii) enter into a tax-deferral agreement with the I.R.S., and (iii) provide adequate security. A covered expatriate may pay the deferred tax, together with accrued interest, at any time before it becomes due.[8]

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6 Amount adjusted for inflation.

7 Note that if gain is recognized at the time of sale, such gain will be subject to Code §897 and a 10% F.I.R.P.T.A. withholding tax will be collected by the buyer.

8 If the expatriate dies before paying all of the deferred tax, the unpaid tax is payable on the due date of the expatriate's final income tax return.

Rules Applicable to the Recipient of Gifts or Bequests

Under Code §2801, "covered gifts" and "covered bequests" made by a covered expatriate to a U.S. resident may be subject to tax (the "succession tax"). The succession tax applies to all covered gifts and covered bequests, regardless of when the gifted/bequeathed property was acquired by the donor/deceased. A covered gift made to a U.S. trust is subject to the succession tax as if the trust were a U.S. citizen. A covered gift made to a foreign trust is not subject to the succession tax, but distributions from such a trust to a U.S. person will be treated as covered gifts.

> Example 5:
>
> John renounced his green card in 2010. His net worth at the time was $3 million. John is a covered expatriate, by virtue of the Net Worth Test. John has two children who are U.S. citizens by birth. In 2025, John purchases an apartment building outside the U.S. worth $10 million. At the conclusion of John's lifetime, his two children, who are U.S. citizens residing outside the U.S., inherit the apartment building. The bequest is a covered bequest.

Covered gifts or covered bequests that are subject to the succession tax are thereby subject to the highest applicable estate tax rate (currently 40%). The succession tax is reduced by foreign gift or estate taxes paid with respect to the transferred property (but not foreign income tax), regardless of whether it is paid by the recipient or the donor/estate.

"Covered gifts or covered bequests that are subject to the succession tax are thereby subject to the highest applicable estate tax rate (currently 40%)."

The recipient of a covered gift receives a basis in the gift that is the same as that in the hands of the donor. In general, unlike property that transfers by bequest, gifts do not provide the recipient with a step-up in basis, regardless of the expatriation rules. Unlike the mark-to-market rules, with respect to the succession tax, there is no provision in the Code that provides for a step up in basis for the tax paid.

The I.R.S. announced in 2009 that reporting and tax obligations relating to the succession tax are deferred pending issuance of guidance and a new Form 708.[9] As of the date of this article, no guidance has yet been published.

Exceptions

Transfers Subject to U.S. Gift or Estate Tax

If a covered expatriate is subject to gift or estate tax with respect to the property, no succession tax will apply to the recipient, provided that a timely gift tax return or estate tax return is filed.

> Example 6:
>
> The same facts apply as in Example 5, but John's apartment building is now located in the U.S. Since the gross estate of a non-resident includes U.S. real property holdings, the bequest will not be a covered bequest.

[9] I.R.S. Announcement 2009-57.

Spousal Gifts and Bequests and Charitable Giving

Succession tax is generally not imposed on gifts and bequests to a U.S. spouse or a U.S. charity.

Annual Exclusion

A gift by a covered expatriate is not a covered gift until it exceeds the annual gift tax exclusion. The annual gift tax exclusion for 2015 is $14,000.

Additional Compliance

Covered expatriates should remember to file new withholding certificates with any payor to replace those reflecting U.S. residency status. Consequently, a Form W-9 previously filed with brokers, investment advisers, and banks must be replaced with Form W-8BEN.

CONCLUSION

Due to the complexity and the graveness of taxation of both expatriates and U.S.-resident recipients of covered gifts and bequests, proper planning is necessary prior to expatriation. Such planning can minimize the total amount of taxes due and, depending on the facts, may even preclude covered expatriate status.

Part III of this series will present various planning opportunities to limit application of the expatriation tax rules.

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Tags
F.A.T.C.A.
I.G.A.

POTENTIAL DISAGREEMENT BETWEEN THE U.S. AND I.G.A. JURISDICTIONS ON HOW TO TREAT NEW INDIVIDUAL ACCOUNTS

Based on the answer to Question 10 under the "General Compliance" heading of the I.R.S.'s F.A.T.C.A. Frequently Asked Questions And Answers webpage, the I.R.S. requires that financial institutions in I.G.A. countries refuse to open new individual accounts if they cannot obtain a Form W-8BEN or a self-certification from the account holder. Conversely, the governments of both the U.K. and Canada have taken the position that under their I.G.A.'s, resident F.F.I.'s can open new individual accounts without self-certifications as long as the accounts are treated as reportable accounts.

In a letter to the Treasury Department released on March 27, the Securities Industry and Financial Markets Association ("S.I.F.M.A.") pointed to this potential disagreement as having inconsistent guidance coming out of the U.S. and other I.G.A. countries. Such inconsistency may hurt American banks with foreign operations. These banks will be placed at a disadvantage if they follow U.S. authority while their competition is allowed to follow less restrictive rules. S.I.F.M.A. does not take a position as to who is right in the disagreement, but expressed their concern about this dispute and the lack of any information on this and similar disputes over the meaning of important I.G.A. terms that will need to be resolved in the future.

I.R.S. TO PUBLISH TECHNICAL EXAMPLE DEMONSTRATING EXCHANGE OF INFORMATION

F.A.T.C.A. reports are to be submitted to the International Data Exchange Service ("I.D.E.S."), which is a secure managed file transfer system that only accepts encrypted transmissions. The I.R.S. announced on March 2 that the I.D.E.S. gateway had been opened for countries and financial institutions to begin transmitting data.

The I.R.S. posted on a service called GitHub a new example showing F.F.I.'s how to create "data packets" of taxpayer account information to transmit using the I.D.E.S. The example also shows how to decrypt a notification.

GitHub is an open source repository hosting service that allows users to collaborate and share code and content. The I.R.S. has made it clear that they do not endorse any commercial product.

I.R.S. HAS ADDED NEW F.A.Q.'S CONCERNING F.A.T.C.A. REPORTING

The I.R.S.'s new F.A.Q.'s clarify certain aspects of the requirement and deadline for filing Form 8966 ("F.A.T.C.A. Report") for certain filers.

The new F.A.Q. 1 provides that a direct reporting N.F.F.E. and a sponsoring entity of a direct reporting N.F.F.E. is required to submit Form 8966 to declare that it has no direct or indirect substantial U.S. owners for the calendar year.

F.A.Q. 2 addresses the question of when Form 8966 is due with respect to calendar year 2014 for participating F.F.I.'s and reporting Model 2 F.F.I.'s.

For participating F.F.I.'s, Form 8966 is due on or before March 31 of the year following the end of the calendar year to which the form relates. With respect to calendar year 2014 only, the instructions to Form 8966 provide for an automatic 90-day extension of time to file Form 8966 without the need to file any form or take any action. The automatic 90-day extension is not available to reporting Model 2 F.F.I.'s reporting on a non-consenting U.S. account.

Thus, filers that benefit from this automatic extension have until June 29, 2015 to submit Forms 8966 or request another 90 day extension to file.

Reporting Model 2 F.F.I.'s reporting on a non-consenting U.S. account should refer to the applicable Model 2 I.G.A. for the due dates of the Forms 8966.

The I.R.S. recognizes that F.F.I.'s will be using the I.D.E.S. system for the first time. Therefore, with respect to calendar year 2014, reporting Model 2 F.F.I.'s filing Form 8966 with respect to non-consenting U.S. accounts will not be treated as being in significant non-compliance under their applicable Model 2 I.G.A.'s, as long as (i) such F.F.I.'s make good faith efforts to comply with their reporting obligations and (ii) reporting is completed within 90 days after the applicable filing deadline (taking into account any other extensions already provided).

SOUTH AFRICA PUBLISHES DRAFT GUIDANCE ON THE IMPLEMENTATION OF THE I.G.A.

A Model 1 I.G.A. was signed by South Africa on June 9, 2014, and entered into force on October 28, 2014. Under the terms of the agreement, starting July 1, 2014, South African F.F.I.'s are required to submit information to the South African Revenue Authority ("S.A.R.S.") for 2014 by June 30, 2015. This data will then be sent to the I.R.S. by S.A.R.S. by September 30, 2015. Thereafter, the required information must be reported to S.A.R.S. annually by May 31, and S.A.R.S. will annually exchange the information with the I.R.S. by September 30.

S.A.R.S. has published a draft general guide on the implementation of the I.G.A. to provide further assistance to South African F.F.I.'s. The I.G.A. is an important stepping stone for South Africa in preparation for the automatic exchange of information in accordance with the O.E.C.D. common reporting standard, to which South Africa is one of the early adopters that committed to commence the standard in 2017.

“To date, the U.S. has signed, or reached an agreement to sign, more than 100 Model 1 I.G.A.’s.”

MAURITIUS TO ISSUE F.A.T.C.A. GUIDANCE

Mauritius and the U.S. signed a Model 1 I.G.A. to implement F.A.T.C.A. on July 5, 2014. The I.G.A. entered into force on August 29, 2014. The guidance, issued by Mauritius on March 20, provides practical assistance to F.F.I.’s, businesses, and their advisors and officials on the application of F.A.T.C.A. in order to ensure that reporting requirements are met and withholding is avoided.

SINGAPORE I.G.A. ENTERS INTO FORCE

Singapore and the U.S. signed a Model 1 I.G.A. on December 9, 2014. Following this, Singapore issued regulations and released a revised e-tax guide on meeting F.A.T.C.A. requirements. The public was invited to respond, and on March 17 the Inland Revenue Authority of Singapore (“I.R.A.S.”) published their responses to the public feedback. I.R.A.S. said it had accepted 208 out of 597 suggestions. The suggestions accepted were those that will help advance the policy objective for implementing the I.G.A., and they have been incorporated into the enacted legislation and the e-tax guide.

CROATIA AND BELARUS SIGN A MODEL 1 I.G.A.

Croatia and the U.S. have signed a Model 1 I.G.A. to implement F.A.T.C.A. and enhance transparency between the two countries. Under the agreement, signed March 20, Croatian F.F.I.’s will be required to submit data on U.S. clients annually to the Croatian tax administrations and the information will be exchanged with the I.R.S. As this is a reciprocal agreement, the I.R.S. will inform Croatia about Croatian residents who are account holders in the U.S.

Belarus has signed a Model 1 I.G.A. on March 18. Last May, the President of Belarus signed a decree approving a draft version of the I.G.A., which gave Belarus the status of having an I.G.A. in effect as of June 6, 2014.

CURRENT I.G.A. PARTNER COUNTRIES

To date, the U.S. has signed, or reached an agreement to sign, more than 100 Model 1 I.G.A.’s. An I.G.A. has become a global standard in government efforts to curb tax evasion and avoidance on offshore activities and encourage transparency.

At this time, the countries that are Model 1 partners by execution of an agreement or concluding an agreement in principle are:

Algeria
Angola
Anguilla
Antigua & Barbuda
Australia
Azerbaijan
Bahamas
Bahrain
Barbados
Belarus
Belgium
Brazil
British Virgin Islands
Bulgaria
Cabo Verde
Cambodia
Canada
Cayman Islands
China
Colombia
Costa Rica
Croatia
Curaçao
Cyprus
Czech Republic
Denmark
Dominica
Dominican Republic
Estonia
Finland
France
Georgia
Germany
Gibraltar
Greece
Greenland
Grenada
Guernsey
Guyana
Haiti
Holy See
Honduras
Hungary
Iceland
India
Indonesia
Ireland
Isle of Man
Israel
Italy
Jamaica
Jersey
Kazakhstan
Kosovo
Kuwait
Latvia
Liechtenstein
Lithuania
Luxembourg
Malaysia
Malta
Mauritius
Mexico
Montenegro
Montserrat
Netherlands
New Zealand
Norway
Panama
Peru
Philippines
Poland
Portugal
Qatar
Romania
Saudi Arabia
Serbia
Seychelles
Slovak Republic
Slovenia
South Africa
South Korea
Spain
St. Kitts & Nevis
St. Lucia
St. Vincent & the Grenadines
Sweden
Thailand
Trinidad & Tobago
Tunisia
Turkey
Turkmenistan
Turks & Caicos Islands
Ukraine
United Arab Emirates
United Kingdom
Uzbekistan

The countries that are Model 2 partners by execution of an agreement or concluding an agreement in principle are: Armenia, Austria, Bermuda, Chile, Hong Kong, Iraq, Japan, Macao, Moldova, Nicaragua, Paraguay, San Marino, Switzerland, and Taiwan.

This list will continue to grow.

IN THE NEWS

AS SEEN IN...

"BEPS Action 4: Limiting Base Erosion via Interest and Other Financial Payments," by Stanley C. Ruchelman and Sheryl Shah, was published in the March/April 2015 edition of the *Journal of Taxation and Regulation of Financial Institutions*. The article explains how the O.E.C.D. proposes to encourage multinational groups to more closely align the interest expense of individual entities with that of the overall group.

Kennneth Lobo's "U.S. Holiday Homes – Top 10 Tax Issues to Remember" was featured in *FYI – GGI International Tax News*. The article compiles the most important points for a non-resident, non-citizen individual acquiring real property in the U.S.

OUR RECENT AND UPCOMING PRESENTATIONS

On December 19, 2014, Stanley C. Ruchelman and Kenneth Lobo presented "The Life of an Outbound Investment from the U.S. into Canada" to the B.C. chapter of the Canadian Bar Association in Vancouver, Canada. The topics addressed included entity classification, tax treatment under Code §367 of asset transfers, Subpart F, P.F.I.C.'s, U.S. and international attacks on excessive benefits, and permanent establishment issues.

On January 18-20, 2015, Stanley C. Ruchelman participated in the *ITSG 2015 Conference* in Calgary. Presentations included: "Double Irish Sandwich: Google Feasts, European Governments Suffer Heartburn," on international pushback on C.F.C. planning arragements; "How Much Equity is Enough Equity in a U.S. Entity?" regarding characterization of intercompany loans; and "Action 4: Limit Base Erosion - Interest Payments and Other Financial Payments," which addressed O.E.C.D. guidance for combatting B.E.P.S.

On February 19-22, 2015, Stanley C.Ruchelman joined the *GGi PG Meeting International Taxation Winter Meeting* in Marbella, Spain, where he presented "Follow up Work on B.E.P.S. Action 6: Preventing Treaty Abuse." The talk addressed the most recent work on B.E.P.S. Action 6, including the release of the second discussion draft for which over 750 pages of comments were submitted by interested parties.

On April 17, 2015, Stanley C. Ruchelman participated in the panel "Exchange of Information Going Global: FATCA, OECD, EU and Beyond" as part of the *ABA/IFA Tax Planning Strategies U.S. and Europe Conference* in Munich, Germany. The discussion outlined the evolution of global exchange of tax information, beginning with the U.S. enactment of F.A.T.C.A. in 2010 and continuing on to the proliferation of similar programs across the globe. It explored the obligations imposed on taxpayers and the overlapping nature of these separate regimes.

On April 23-26, 2015, Galia Antebi will attend the *GGi European Regional Conference* in Lausanne, Switzerland. She will lead a workshop on “The Post FATCA Form W-8: How to Assist your Clients to Correctly Complete this Form.” Through real world situations, particpants will learn to navigate the complexities of Form W-8 and its equivalents, by which entities provide F.A.T.C.A. status certification from over 30 possibilities. Ms. Antebi will also lead a discussion on “Wealth Planning in the New Information Age” as part of the Trust & Estate Planning Practice Group. The panel will address the impact information demands, information exchanges, and erosion of taxpayer confidentiality have on the modern approach to client work.

Copies of our presentations are available on the firm website at www.ruchelaw.com/publications.

About Us

We provide a wide range of tax planning and legal services for foreign companies operating in the U.S., foreign financial institutions operating in the U.S. through branches, and U.S. companies and financial institutions operating abroad. The core practice of the firm includes tax planning for cross-border transactions. This involves corporate tax advice under Subchapter C of the Internal Revenue Code, advice on transfer pricing matters, and representation before the I.R.S.

The private client group of the firm also advises clients on matters related to domestic and international estate planning, charitable planned giving, trust and estate administration, and executive compensation.

The tax practice is supported by our corporate group, which provides legal representation in mergers, licenses, asset acquisitions, corporate reorganizations, acquisition of real property, and estate and trust matters. The firm advises corporate tax departments on management issues arising under the Sarbanes-Oxley Act.

Our law firm has offices in New York City and Toronto, Canada. More information can be found at www.ruchelaw.com.

Disclaimer

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