ruchelman
corporate
international
taxation

INSIGHTS

O.E.C.D. AND EUROPEAN COMMISSION UNVEIL PROPOSALS ON TAXATION OF THE DIGITAL ECONOMY

MANAGING A TRANSFER PRICING EXAM? WASH YOUR HANDS WITH SOAP AND WATER

THE F-1 VISA – PRIVILEGED U.S. TAX STATUS AND HOW TO KEEP IT

AND MORE

Insights Vol. 5 No. 5

TABLE OF CONTENTS

Editors' Note

O.E.C.D. and European Commission Unveil Proposals on Taxation of the Digital Economy.................................... 4

Do India's Amalgamation Revisions Prevent Misuse of Accumulated Losses?.............. 11

Managing a Transfer Pricing Exam? Wash Your Hands with Soap and Water....................... 15

The F-1 Visa – Privileged U.S. Tax Status and How to Keep It 21

Corporate Matters: Profits Interest Basics 29

Foreign investor in a U.S. L.L.C. – How to Minimize Withholding Tax on Sale of L.L.C. Interest .. 32

I.R.S. Announces Six Compliance Campaigns 38

Updates and Other Tidbits....... 41

About Us

EDITORS' NOTE

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

- **O.E.C.D. and European Commission Unveil Proposals on Taxation of the Digital Economy.** Following the release of the O.E.C.D.'s B.E.P.S. Action Plan and the E.U.'s approval of the Anti-Tax Avoidance Package, the taxation of the digital economy continues to be unfinished business in the international tax arena. New O.E.C.D. and the European Commission documents mark a milestone, especially the latter, which include two different approaches. They also highlight the difficulties in achieving a consensus, which seems desirable when implementing measures that increase the tax burden of digital activities. José Luis Gaudier of Cuatrecasas, Barcelona, delves into the O.E.C.D. and the European Commission approaches to taxing the digital economy.

- **Do India's Amalgamation Revisions Prevent Misuse of Accumulated Losses?** India's recent Finance Act addressed a tax planning device intended to reduce or eliminate the imposition of the Dividend Distribution Tax ("D.D.T") that applies when a corporation exercises the right to distribute dividends to shareholders. The statue targets plans involving an amalgamation between a profitable company and a loss company and prevents the reduction of earnings when the profitable company is the acquiring company. Does this mean that earnings can be reduced when the loss company is the acquiring company? Differing views have been expressed by Indian tax advisers. CA Anjali Kukreja of R.N. Marwah & Co L.L.P., New Delhi, examines both views and explains why one view is technically preferable.

- **Managing a Transfer Pricing Exam? Wash Your Hands with Soap and Water.** For management of a U.S. subsidiary of a foreign parent, the process by which the I.R.S. conducts an examination of a tax return creates a heightened stress level. It begins with the arrival of an information document request ("I.D.R.") for transfer pricing documentation, which often comes as a surprise to a company. Typically, two or three years have passed since the close of the year under examination and little is recalled about transactions. From there, the expressed positions of I.R.S. examiners and management often are at odds. Drawing on many years of experience in defending intercompany transfer pricing policies, Michael Peggs takes a step back from the fray to examine how opposing, pre-conceived notions on both sides combine with the Semmelweis Reflex to exacerbate what should be a straightforward tax examination.

- **The F-1 Visa – Privileged U.S. Tax Status and How to Keep It.** Foreign students leaving their home country and arriving in the U.S. for higher education may come across many things that seem alien to them – like the accent, culture, and inexplicably large food portions. But one area where they are treated as the aliens is under U.S. Federal income tax law, where foreign students holding F-1 visas are treated as nonresident aliens who are subject to special tax provisions. Neha Rastogi and Beate Erwin discuss tax residence status, Federal income tax consequences, and U.S. reporting requirements for holders of F-1 visas.

- **Corporate Matters: Profits Interest Basics.** In the latest in his series of articles on the relative flexibility of limited liability companies and their desirability for use in many instances, including joint ventures, Simon H. Prisk looks at grants of profits interests as a means of compensating service providers and employees. If done properly, these incentives can be optimized by favorable tax treatment, achieving the same or better tax results than incentive stock options available to C-corporations and S-corporations. If done without proper thought and planning, the results may be suboptimal.

- **Foreign Investor in a U.S. L.L.C. – How to Minimize Withholding Tax on Sale of L.L.C. Interest.** U.S. tax law was revised in last year's tax reform legislation to impose tax on non-U.S. persons recognizing a gain from the sale of a partnership that engages in a U.S. business. Worse, purchasers must collect and pay over to the I.R.S. a withholding tax equal to 10% of the amount realized by the seller. Because of the way U.S. tax law treats partners of partnerships financed with debt, the withholding tax can be greater than the cash that is set to be paid to the foreign seller. In April, the I.R.S. issued guidance on the problem, leading some to recommend a two-step plan to align the withholding tax with the ultimate income tax that will be due. Fanny Karaman and Stanley C. Ruchelman explain the I.R.S. guidance and the two-step plan.

- **I.R.S. Announces Six Compliance Campaigns.** The I.R.S. Large Business and International division ("LB&I") recently announced compliance campaigns that are principally directed at compliance in cross-border fact patterns. Included are campaigns to address (i) non-compliance with respect to Form 3520, (ii) compliance issues related to Form 1042, (iii) nonresident, non-citizen individuals inappropriately claiming tax treaty exemptions, (iv) nonresident, non-citizen individuals inappropriately claiming itemized deductions on tax returns, and (v) inappropriate credits claimed by nonresident, non-citizen individuals. Elizabeth V. Zanet looks into the various campaigns and places into context the effect on individuals.

- **Updates and Other Tidbits.** This month, Rusudan Shervashidze and Nina Krauthamer look at several interesting updates and tidbits, including (i) limited relief for transition tax, (ii) a new twist to phishing that involves fake I.R.S. calls, (iii) another twist on phony correspondence requesting W-8BEN information that is used to obtain persona information often used by banks to confirm identities of customers, and (iv) new FinCEN money transmitter rules that apply to I.C.O.'s.

- The Editors

O.E.C.D. AND EUROPEAN COMMISSION UNVEIL PROPOSALS ON TAXATION OF THE DIGITAL ECONOMY

Author
José Luis Gaudier

Tags
Digital Economy
European Commission
O.E.C.D.

BRIEF SYNOPSIS

Following the release of the O.E.C.D.'s B.E.P.S. Action Plan and the European Union's approval of the Anti-Tax Avoidance Package, the taxation of the digital economy continues to be unfinished business in the international tax arena. New O.E.C.D. and the European Commission ("E.C.") documents mark a milestone (especially the latter, which include two different approaches). They also highlight the difficulties in achieving a consensus, which seems desirable when implementing measures that increase the tax burden of digital activities.

INTRODUCTION

After several years of work, the O.E.C.D.'s[1] Tax Challenges Derived from Digitalization – Interim Report, 2018 ("Interim Report") was published on March 16 and approved on March 20 by the G-20 after a meeting in Buenos Aires.[2] The E.C. released several documents on March 21: two proposals for a Council Directive (the "Directive Proposals"), a recommendation for the Members States, and a communication for the Council and the European Parliament.[3]

None of these documents has direct implications for taxpayers, although they establish the course for future developments.

The main aspects that should be taken into account may be summarized as follows:

- Both the O.E.C.D.'s Interim Report and the E.C.'s documents start from the same basic premise: The digitalization of the economy and the limitations of the current rules to allow for taxation of value where it is created (a crucial, unquestioned principle) lead to an unlevel playing field and a risk for states' tax revenues. Consequently, the criteria for allocating taxing rights among

José Luis Gaudier is a partner in the Tax Practice of Cuatrecasas in Barcelona. Mr. Gaudier focuses on international taxation and advising international groups and venture capital entities. He has ample experience in international reorganizations of multinational groups and cross-border M&A transactions.

---

1 Through the Inclusive Framework and the Task Force on the Digital Economy, a dependent body of the Committee on Fiscal Affairs of the O.E.C.D., working groups where both members and non-members of the O.E.C.D. are included, which shows the widespread approach of the project.

2 The *communiqué* of the G-20 Meeting of Finance Ministers and Central Bank Governs of 2018 mentions that:

> The impacts of the digitalization of the economy on the international tax system remain key outstanding issues. We welcome the OECD interim report analyzing the impact of digitalization of the economy on the international tax system.

3 The E.C. has published an impact assessment explaining the basis of the measure. Although mandatory rules are not in this document, it includes comments and data important for understanding the E.C.'s proposals.

states, known as nexus, and the criteria for calculating tax liabilities, known as profit allocation, should be reviewed to confirm that the rules are adapted to the current situation.

- States' concerns and interests, which are in conflict at times, make an international consensus impossible to achieve. Although the consensus is desired by all the parties, some international actors have implemented unilateral measures that could generate economic inefficiencies.

- The E.C. has released both long-term and short-term solutions in order to address the tax-related challenges raised by the digital economy. In comparison, the O.E.C.D. has not managed to produce a concrete proposal, given the need for consensus. Some alternatives have been analyzed and the comments expressed are relevant.

- The E.C.'s long-term proposal creates a new nexus standard and establishes the profit split as the default profit allocation method. (This is not a commonly used method because of practical difficulties.) While the nexus approach is defined in straightforward terms in the Directive Proposal, the criteria for profit allocation requires further development to avoid situations of overtaxation or nontaxation. Assuming this measure will create consensus within the E.U., it will require an amendment of double tax conventions ("D.TC.'s") signed with non-E.U. states. This will take time.

- The digital services tax, a short-term solution proposed by the E.C. and applicable as an interim measure, has been drafted in detail, so it can be implemented if there is a consensus within the E.U. or if the Member States are willing to implement this measure as if it were approved. This tax is levied on three types of specific digital services: on line advertising, transfer of user data, and intermediation on platforms that allow interaction between users. The implementation of this measure could run into legal problems, as its compatibility with D.T.C.'s and E.U. law is questionable, as pointed out in the analysis of short-term proposals in the O.E.C.D.'s Interim Report.

THE O.E.C.D. APPROACH

Today, there is no doubt about the active involvement of the O.E.C.D. and the E.U., particularly the E.C., in reviewing international taxation standards and current challenges regarding the taxation of the digital economy. Intense activity, largely coordinated, has taken shape with the publication of the aforementioned O.E.C.D. and E.C. documents. Although only intermediate measures in the broader process of analyzing the taxation of the digital economy, each sheds light on the current situation and the trend that guides the process.

The O.E.C.D. Interim Report

It is well known that the effects of the digital economy in the field of taxation are linked to the origin and the *raison d'etre* of the O.E.C.D.'s B.E.P.S. Action Plan. As a reference, Action 1 was titled "Addressing the Tax Challenges of the Digital Economy."[4] However, this action does not include a specific recommendation to

[4] Considering that the Interim Report is titled "Tax Challenges Derived from Digitalization," one can observe a certain change of focus in the works, if it is

that effect. Instead, it calls on states to review the progress made through the plan's other actions and to seek consensus by 2020.

The Action 1 Final Report reflects the expectation that the measures of the B.E.P.S. Project could be sufficient to substantially address the challenges raised by the digital economy.[5] Together with the lack of consensus, this seems to be one of the reasons why Action 1 does not recommend introducing concrete measures relating to the broader tax challenges of the digital economy, such as establishing a nexus relating to a significant digital presence, withholdings for digital transactions, or an equalization levy.

"Because of the absence of consensus, the O.E.C.D.'s Report does not include specific proposals."

The O.E.C.D. has presented the Interim Report as a means to describe the development of this work under the mandate that it is necessary not only to establish new regulations on the matter that can adapt to a changing environment but also to provide certainty and facilitate growth.

One of the starting points of the Interim Report confirms that, to date, implementation of the B.E.P.S. Action Plan has achieved significant progress in two areas:

- The lawmakers recognize an emerging B.E.P.S. effect, which can be verified by analyzing the new developments in domestic tax legislation inspired by the B.E.P.S. Action Plan. At a regional level, an example would be the activity of the E.U., and at a global level, it would be the adoption of the Multilateral Instrument.[6]
- Companies have modified some business models by giving prevalence to their local agents, by passing from a remote sales model to a local reseller model, or by aligning their corporate structures with the economic activity actually carried out, accomplishing the latter by reviewing transfer pricing policies and reconsidering the location of their intangible assets, graphically described as "on-shoring assets."[7]

---

understood that the focus is transferred from the digital economy to a wider phenomenon such as digitalization that affects the economy as a whole, including tax administrations.

5 "As a result, it is expected that the implementation of these measures, as well as other measures developed in the BEPS Project, will substantially address the BEPS issues exacerbated by the digital economy." ("Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report," O.E.C.D./G-20 Base Erosion and Profit Shifting Project (O.E.C.D. Publishing, Paris: 2015), p 94.)

6 At this point, we highlight the low percentage of adoption to date (17%) of the modifications related to the existence of a permanent establishment ("P.E.") in the case of *commissionaire* agreements. These structures are traditionally used in the field of the digital economy. The O.E.C.D. recognizes this low acceptance in the Interim Report, although it also points out the possibility that adoption rates may increase when progress is made in the work related to attributing benefits to P.E.'s or due to their inclusion in the O.E.C.D. Model Tax Convention.

7 In practical terms, this change in the companies' business models facilitates the analysis of the nexus problem, although it brings the discussion back to profit allocation in the case of a local reseller. It is striking that the O.E.C.D. document reflects two positions: (i) Member States that recognize that this change has allowed a widening of taxable bases in their jurisdictions when moving from a remuneration based on costs to one based on sales and (ii) Member States

However, Action 1 also recognizes that it is necessary to carry out follow-up work to address the broader challenges raised by the digital economy. This particularly applies to the concept of nexus, the value of data, and the characterization of digital operations. Therefore, the implementation of additional measures is necessary. Following this insight in its Interim Report, the O.E.C.D. acknowledges that the progress of the B.E.P.S. Action Plan may not be sufficient.

Because of the absence of consensus, the O.E.C.D.'s Report does not include specific proposals. This lack of consensus is not minor. It reflects the importance of needed modifications in the areas pointed out and the relevance of data and user participation in the rules regarding distribution of benefits and distribution of tax powers among states.

Countries seem to be grouped by blocks. The Interim Report identifies three blocks of jurisdictions:

- A first group of countries understands that the main challenges raised by the digitalization of the economy refer to the value of the data and the participation of the user as key elements in the process of creating value. These countries do not suggest that the principles on which international taxation is based should be modified as a consequence of the digitalization of the economy. Rather, they simply maintain that the rules must be adapted to consider the relevance of the value of the data and the participation of the user. Some E.U. countries such as Spain maintain this position.

- A second group of countries pleads for a thorough revision of the principles of international taxation relating to the concepts of nexus and the attribution of benefits. The rationale is that the digitalization of the economy is a general phenomenon that affects most digital business models. Some countries, such as the U.S., maintain that data and user participation are not relevant *per se* to the process of creating value but that they should be treated as inputs for the company.

- A third group of countries understands that significant reform in the field of international taxation is not necessary after the B.E.P.S. Action Plan. This group consists of countries that have taken advantage of the current rules to become centers for digital companies and often provide a reduced tax burden.

The classification of the different jurisdictions can be interpreted as an initial step from which the work of the O.E.C.D. can proceed.[8] The document approved by the

---

that denounce that, in essence, the tax base remains essentially the same considering that the remuneration that the reseller must receive for the functions performed is not far from the remuneration that under the previous scheme should have received commissionaire. From a Spanish standpoint, the position that the tax authorities *sometimes* maintain is the differences between the compensation that corresponds to an agent, according to arm's length, and the economic result of the activity that is developed through a subsidiary or a P.E.

8 These different positions are derived from the value chains of the states involved. The U.S. position is consistent with a state where value is created through research and development activities with high added value intangibles. However, the position of certain European states with large populations logically emphasizes the relevance of the client (*i.e.*, user). In an intermediate situation, hub states have opted for a service platform model for digital businesses,

O.E.C.D. expects an update on the progress of the work. A new Interim Report is expected in 2019 and a Final Report is expected in 2020, in which a consensus is expected to be reached.[9]

THE E.C. APPROACH

E.U. concerns about the taxation of the digital economy first arose at the Summit of Heads of State and Government held in Tallinn in September 2017. They were proceeded by the conclusions of the E.C. and Ecofin in October and December of the same year and finally by the E.C.'s active collaboration with the O.E.C.D.

The E.U.'s vision, now represented by the E.C.,[10] centers on certain characteristics of the digital economy – lack of physical presence, importance of intangible assets, and relevance of data and user participation – for which the current tax rules are not adapted, allowing digital companies to bear a low tax burden that reduces tax collection and distorts competition. The same ideas underlie the O.E.C.D.'s work.

While there is no consensus at the O.E.C.D. level, the E.C. maintains a clear position in this area, based on the following precepts:

- A unified solution at the international level within the O.E.C.D. is desirable. However, its attainment presents certain challenges, and reaching a consensus will take time. The E.C. supports the attainment of consensus by proposing concrete solutions that can "serve as an example" at the international level.
- Measures taken in the absence of O.E.C.D. consensus should have at least an E.U. consensus and be consistent at the E.U. level. Impatience at the level of the O.E.C.D. has led to the introduction of unilateral measures, which threaten to fragment the unique digital market and distort competition.
- "It's a matter of justice" to make modifications that give an appropriate fiscal response to the challenges posed by the digitalization of the economy.
- Data and user participation are important in the digital economy. This argument underlies the E.C.'s assertion about the current discord between the place of taxation of benefits and the place of creation of value. All of the E.C. proposals reflect a consensus on the value of data and user participation in the process of creating value.
- The desirable solution to achieve fair taxation of the digital economy relies on the concept of significant digital presence. It is proposed that this concept be added to the definition of P.E., whose benefits would be attributed under

which are comfortable with the classic definitions.

9 As mentioned in the *communiqué* of the G-20 Meeting, "We are committed to work together to seek a consensus-based solution by 2020, with an update in 2019."

10 We also highlight the media impact achieved by the letter signed in September 2017 by the Ministers of Finance of France, Germany, Spain, and Italy (which Austria, Bulgaria, Slovenia, Greece, Poland, and Portugal later signed) addressed to the Presidency of the E.U. in favor of introducing an equalization tax.

a functional analysis that takes into account the value of the data and the user's participation as a critical issue. This solution appears in the Proposal for a Council Directive Laying Down rules Relating to the Corporate Taxation of a Significant Digital Presence. According to the Proposal, once implemented in domestic legislations, this Directive would be effective within the E.U. and within states without D.T.C.'s in force, but not with non-E.U. countries that have signed D.T.C.'s with Member States. To facilitate the work of modifying these conventions, the E.C. has issued a Recommendation Relating to the Corporate Taxation of a Significant Digital Presence.

- As a long-term solution will take time, a new tax levied exclusively on certain digital services ("Digital Services Tax" or "D.S.T."[11]) will be introduced as an interim measure. The main feature of this tax is the relevance of the user's participation in a digital activity as a central element in creating value. It defines three types of services in which this circumstance occurs, leaving all other cases outside the scope of the D.S.T. This short-term solution is also projected in the form of the Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services.

The E.C. has also published a Communication to Parliament and the Council, named Time to Establish a Modern, Fair and Efficient Digital Economy Standard, as a summary of the proposed measures which are substantiated in the two Directive Proposals. The E.C.'s initial position is to process each Directive Proposal as a directive. They have been submitted for consultation to the Parliament and the Council for adoption.

The E.C. proposes the above texts "in a strict sense," meaning they should be analyzed at the E.U. level to ensure they have the modifications required and consensus for approval as directives. Given the possible lack of consensus, the focus is on the enhanced cooperation procedure, which allows a minimum of nine E.U. countries to establish advanced integration or cooperation in an area of European structures without the participation of the other E.U. countries.[12]

CONCLUSION

The digitalization of the economy is a complex issue, raising problems from both a legal and a political point of view. From a legal standpoint, it questions the fundamental rules of international taxation. Politically, the pressure from stakeholders to tax these activities is as high as the discrepancies between states about the way to do it.

---

11 When using Spanish terms, some confusion could be avoided if the terminology the E.C. uses (*Impuesto sobre Servicios Digitales* – I.S.D.) is replaced with an alternative acronym (I.S.D.i.), as the former is usually used in Spain to refer to the Inheritance and Gift Tax (*Impuesto sobre Sucesiones y Donaciones* – I.S.D.).

12 At a press conference on March 21, Commissioner Moscovici was asked about the possible application of the enhanced cooperation procedure to achieve progress on the proposals. Moscovici expressed his optimism on the possibility of reaching a consensus within the E.U., so that it would not be necessary to resort to this unfavorable option.

“The new rules proposed by the E.C. (and analyzed by the O.E.C.D.) depart so markedly from the traditional legal framework of international taxation that they require additional work from both institutions.”

In this situation, both the O.E.C.D. and the E.C. are attempting to generate consensus. By its nature, the O.E.C.D. seeks a quasi-global consensus, which is difficult to achieve. Additionally, it may not be easy for the E.C. to get all E.U. Member States to accept its proposals, without using the enhanced cooperation mechanism (which is not desirable).

Regarding the E.C.'s proposals, it is notable that it establishes a long-term solution together with a short-term, interim solution to avoid the serious problem of fragmenting the common market.

The E.C.'s long-term measure will be effective only if there is consensus at the O.E.C.D. level, which does not exist today. This leads to questions of whether the proposal to rely on significant digital presence, rather than to significantly alter existing tax rules, has important political content and how this positions the E.U. in the international discussion on the taxation of the digital economy.

Regarding the interim solution to establish a D.S.T., there is concern that the measure that could be implemented unequally in the E.U., because of a lack of consensus between Member States. In contrast with the long-term solution, this measure is defined in clear terms (probably more characteristic of a regulation than of a directive) and its implementation, based on a tested V.A.T. mechanism, should not be complex. However, its implementation sparks certain questions: How should a tax be assessed if it is designed to grant taxing rights to a state in a situation where, under a D.T.C., that state would have been prevented from taxing the income? And to what extent can existing taxes and this new tax have a different nature, essentially on the basis of formal arguments, when the economic capacity that they both seek to tax, in light of the facts, is the same?

In conclusion, the new rules proposed by the E.C. (and analyzed by the O.E.C.D.) depart so markedly from the traditional legal framework of international taxation that they require additional work from both institutions to remove any doubts raised about their validity and ability to achieve the objective that digital activities support fair taxation. This work should take into account, in particular, possible conflicts between taxpayers and tax administrations that could arise from the introduction of measures of this nature.

DO INDIA'S AMALGAMATION REVISIONS PREVENT MISUSE OF ACCUMULATED LOSSES?

Author
CA Anjali Kukreja

Tags
Corporate Reorganization
Dividend Distribution Tax
India

CA Anjali Kukreja is a manager at R.N. Marwah & Co LLP, a leading Indian accounting firm headquartered in New Delhi. She is experienced in the field of international tax with a focus on mid-market global M&A.

INTRODUCTION

India's Finance Act, 2018 addressed a tax planning device intended to reduce or eliminate the imposition of the Dividend Distribution Tax ("D.D.T."), which applies when a corporation exercises the right to distribute dividends to shareholders. The D.D.T. serves as a dividend withholding tax. However, because it is imposed on the Indian company paying the dividend and not on the shareholder, favorable income tax treaty provisions are not applicable. This article compares the prior law to two possible interpretations of the amendment and examines the intent of the amendment.

INDIAN TAX LAW BEFORE THE AMENDMENT

The D.D.T. Mechanism

Section 115O of the Income-tax Act, 1961 ("Act") provides for the D.D.T. It is imposed at the rate of 15% plus applicable surcharge and cess[1] whenever a dividend is declared, distributed, or paid by a domestic company. The term "dividend" covers a deemed dividend.[2] It also includes any distribution to shareholders in a reduction of capital3 when a company possesses accumulated profits, even if capitalized. Accumulated profits[4] include all profits of the company up to the date of distribution for the purpose of section 2(22)(d) of the Act.

Strategy to Avoid D.D.T. on Payments to Shareholders in Capital Reductions

In order to avoid D.D.T., certain unlisted companies, mainly multinationals resort to the "Purchase Method"[5] of amalgamation[6] wherein a profit-making company with substantial accumulated profits is amalgamated with a company having significantly lower profits, or even losses. Fixed assets (including bank accounts and cash) of

---

1 A cess is an additional income tax, leviable over and above, the basic tax rate and surcharge (if applicable). Currently, the rate of the cess is 4%.

2 Section 2(22)(e) of the Act.

3 Section 2(22)(d) of the Act.

4 Explanation 2 to section 2(22) of the Act.

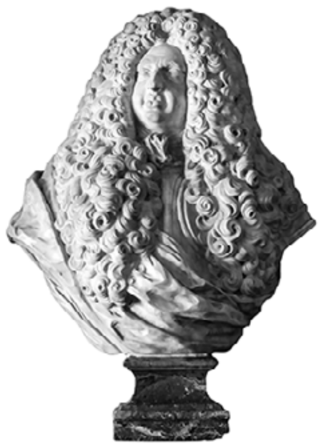
5 Assets and liabilities are purchased at a mutually agreed value ("purchase price"). This is different from an amalgamation under the "Pooling of Interest Method" where there is a line-by-line addition of book values.

6 "Amalgamation" in relation to companies, means a merger of two or more companies to form one company.

the "Amalgamating Company"[7] are transferred to the "Amalgamated Company."[8] Accumulated profits of the Amalgamating Company are not recorded or accounted for in the books of the Amalgamated Company (*i.e.*, the assets lose their identity). The books of the Amalgamated Company contain its accumulated losses as well as its assets (as held prior to the amalgamation) with the addition of newly acquired cash, bank balances, or other assets.

After amalgamation, the Amalgamated Company reduces capital to write off the accumulated losses by resorting to any of the following:

- Cancelling paid-up share capital against accumulated losses
- Distributing cash to the shareholders for paying off any paid-up share capital that is in excess of the wants of the company[9]



Upon this distribution of cash on capital reduction, the company circumvents payment of D.D.T. under section 2(22)(d) of the Act, as the D.D.T. is applicable on a distribution of cash only to the extent of accumulated profits and the Amalgamated Company typically does not have any such profits.

AMENDMENT IN INDIAN FINANCE ACT, 2018

> In the case of an amalgamated company, the accumulated profits, whether capitalized or not, or loss, as the case may be, shall be increased by the accumulated profits, whether capitalized or not, of the amalgamating company on the date of amalgamation [emphasis added].[10]

Interpretations of the Amendment

What does the amendment mean? Two contrasting viewpoints have been expressed.

View 1

In cases where the Amalgamating Company has accumulated losses, they will not be recorded in the books of the Amalgamated Company. Only in cases where the Amalgamating Company has accumulated profits will they be added to the accumulated profits or losses of the Amalgamated Company.

View 2

Accumulated profits or accumulated losses (as the case may be) of the Amalgamating Company will be recorded in the books of the Amalgamated Company. The omission of the expression "or losses, as the case may be" in the context of the Amalgamating Company is not deliberate.

7 Transferor company (which is merged inside the other company) is referred to as the Amalgamating Company.

8 Transferee company (which is formed as a result of the merger) is referred to as the Amalgamated Company.

9 Section 66 of the Companies Act 2013 allows reduction of share capital through cancellation against paid up share capital as well as cash.

10 Inserted vide Explanation 2A to section 2(22) of the Act.

Analysis of the Viewpoints

A literal reading of the exact words of the amendment would mean that in the case of an Amalgamated Company,

- accumulated profits . . . , **or losses**, as the case may be,
- "shall be increased by"
- "the accumulated profits" of the Amalgamating Company.

Exact interpretation to mean that

- the Amalgamated Company can either have accumulated profits or loss, and
- the accumulated profit or loss of the Amalgamated Company will be increased by the accumulated profits of the Amalgamating Company.

A bare reading of the plain language suggests that, only in cases where the Amalgamating Company has substantial accumulated profits, such accumulated profits would be added to the accumulated profits or losses of the Amalgamated Company.

The language clearly uses the expression "accumulated profits or losses as the case may be" for the Amalgamated Company, whereas it uses the expression "increased by accumulated profits of the amalgamating company." It is evident that the use of the word "losses" for the Amalgamated Company and its omission for the Amalgamating Company is conscious and intended.

Object of the Legislation

The language of the explanatory memorandum to Finance Bill 2018 clarifies that the intent of introducing this amendment is to prevent abusive arrangements for tax avoidance through amalgamations. The relevant extract is reproduced below:

> Instances have come to light whereby companies are resorting to abusive arrangements in order to escape liability of paying tax on distributed profits. Under such arrangements, companies with large accumulated profits adopt the amalgamation route to reduce capital and circumvent the provisions of sub-clause (d) of clause (22) of section 2 of the Act. With a view to preventing such abusive arrangements and similar other abusive arrangements, it is proposed to insert a new Explanation 2A in clause (22) of section 2 of the Act to widen the scope of the term 'accumulated profits' so as to provide that in the case of an amalgamated company, accumulated profits, whether capitalized or not, or losses as the case may be, shall be increased by the accumulated profits of the amalgamating company, whether capitalized or not, on the date of amalgamation [emphasis added].[11]

The law aims to target the misuse of amalgamation arrangements wherein the Amalgamating Company has substantial accumulated profits and the intent of the amalgamation is to distribute these profits by way of a capital reduction without paying D.D.T.

---

[11] Clause 3 of the Memorandum Explaining the Provisions of Finance Bill, 2018.

An inverse arrangement (*i.e.*, wherein the Amalgamating Company has substantial accumulated losses and the Amalgamated Company has substantial accumulated profits) is not intended to be covered by this amendment. This would mean that post amalgamation, by virtue of the amendment (under View 2), the Amalgamated Company may record losses (due to addition of substantial accumulated losses to the profits of the company). On applying this interpretation, we come back to square one, as the Amalgamated Company, on reduction of its capital, may now be able to circumvent the provisions of section 2(22)(d) of the Act. This interpretation renders the amendment ineffective when the Amalgamating Company has losses.

"The intent of introducing this amendment is to prevent abusive arrangements for tax avoidance through amalgamations."

Parallel Provision

The arrangement is reminiscent of section 72A of the Act introduced vide Indian Finance Act, 1977. This section relates to the carry forward and set off of accumulated loss and unabsorbed depreciation allowance in an amalgamation or demerger. Section 72A aims to prevent tax avoidance under an amalgamation arrangement where the Amalgamating Company is a loss-making company and the intent of the amalgamation is to avoid tax payment by the profit-making Amalgamated Company – as under such an arrangement, the profit-making company would be able to reduce taxes by taking advantage of the business losses and unabsorbed depreciation of the Amalgamating Company. Therefore, this section limits the tax benefit under artificial amalgamation arrangements (*i.e.*, undertaken without honest business considerations). This section also contains conditions whereby genuine business amalgamations do not suffer and companies are able to revive or expand their business.

CONCLUSION

If the Amalgamating Company is a loss-making company and the amalgamation is aimed at genuine revival of business under due commercial considerations, the interpretation under the View 1 (*i.e.*, that Amalgamated Company only gets accumulated profits and not losses of Amalgamating Company) allows the Amalgamating Company to leave behind the losses. After amalgamation, if the Amalgamated Company is a profit-making company, it would be in a better position to raise money from investors or arrange credit or loans to fund and revive its business operations. This interpretation seems to be in alignment with intent of the Indian government in preventing misuse of accumulated losses through amalgamations between loss-making and profit-making companies. At the same time, it also keeps the door open for the revival of loss-making companies through amalgamation arrangements. Furthermore, the Indian government does not aim to adversely affect genuine amalgamation arrangements taken for honest business expansion or revival purpose. The intent of the Indian government is to only block artificial arrangements. Mostly such an amendment would cover arrangements wherein two companies not engaged in the same or similar businesses join together so that available accumulated losses can be used strategically (for undue income tax benefit). This amendment is effective from April 1, 2018 (*i.e.*, the Indian financial year comprising the period from April 1, 2017 to March 31, 2018) and this will be the first year of implementation, only the time will tell whether the changes are effective. Has the Indian government achieved its goal of preventing the misuse of accumulated losses? Will this provision lead to increased litigation? Or will the affected taxpayers devise new methods of avoiding tax using amalgamation or merger arrangements?

MANAGING A TRANSFER PRICING EXAM? WASH YOUR HANDS WITH SOAP AND WATER

Author
Michael Peggs

Tags
Audit
I.D.R.
Transfer Pricing

The arrival of an information document request ("I.D.R.") for transfer pricing documentation often comes as a surprise to a company. Typically, two or three years have passed since the year under examination and little is recalled about transactions reported on a Form 5472, which reports transactions with controlled taxpayers such as a foreign parent or a related supplier outside the U.S. Yet, in today's post-B.E.P.S. world, international examinations with a focus on transfer pricing are commonplace.

The I.R.S. transfer pricing exam process and resource infrastructure was built for large multinational companies that participate in most of the controlled transactions that cross borders. A considerable amount of information is needed by a taxpayer in order to select and apply a specified or unspecified transfer pricing method and to explain the associated assumptions and conclusions.

Bob Rinninsland and I discussed the implications of the I.R.S. Transfer Pricing Roadmap[1] and the Quality Examination Process[2] in a 2014 issue of *Insights*.[3] At that time, Bob predicted a more fact-driven audit process would become the norm, with less immediate focus being placed on the selection and application of a transfer pricing method. Amid the turmoil of the B.E.P.S. Project, I thought that the O.E.C.D. approach – in which a transfer pricing theory goes searching for facts – might become more commonplace among tax examiners.

While the I.R.S. is moving in the direction that Bob expected, some old habits of tax administrations, companies and their tax executives, and advisors have not changed. Transfer pricing exams are not like dual-authored articles in a tax journal. Neither side is satisfied with being partially correct at the end of a transfer pricing exam.

In an attempt to avoid negative results from the taxpayer side or the examination team side, each may engage in behavior reflecting cognitive bias and other influences.[4] These biases and behaviors often result in conflict between the participants in the examination process. Economists understand that the outcome of a transfer pricing dispute is as much a function of the behaviors and interactions of the taxpayer and the examination team as the strength of the technical arguments concerning

---

1 Transfer Pricing Audit Roadmap, (February 2014).

2 Achieving Quality Examinations through Effective Planning, Execution and Resolution, Pub. 04837 (Rev. November 2010).

3 "I.R.S. vs. O.E.C.D. – How Are Tax Authorities Planning to Conduct Your Next Transfer Pricing Audit," *Insights* 2 (2014).

4 We refer to the principles of psychology imported into the economics discipline most notably by Daniel Kahneman and Amos Tversky in the 1970's through the 1990's. The field is known today as behavioral economics.

comparability and assumption reliability that underlie the company's position and that of the examination team.

Transfer pricing exams and dispute resolution is a vast topic. I will focus on three aspects of transfer pricing exams where trouble typically arises. These are

- various forms and sources of cognitive bias,
- neglect of the regulations in favor of adopted heuristics, and
- inadequacies in documentation and *ex ante* analysis of several types.

COGNITIVE BIAS

Several types of cognitive bias frustrate the review of the application of the best method rule,[5] and create impasses to managing the effects of contrary positions held by the I.R.S. and companies.

Before an exam starts, the objectives of the players involved are reasonably clear. Companies want the I.R.S. to review their materials and understand and "buy into" each pricing position, so that field work may be concluded quickly with no income adjustment and no double taxation. The I.R.S. wants to verify that the facts in the company's transfer pricing documentation are true, test the major assumptions contributing to the pricing positions, and check and understand the data employed and calculations performed either in the transfer pricing documentation or by the company as it determines transaction values during a tax year.

Advisors expect that the position they have determined to be sustainable will be challenged by the I.R.S. but is highly likely to hold. Furthermore, they assume management of the company will share its viewpoint.

Contradictory and undiscovered facts, a contrarian position on method or analysis adopted by the I.R.S., or an income adjustment may cause companies to view their original position with some bias. New evidence that emerges from I.R.S. I.D.R.'s, meetings, and key executive interviews is often rejected by companies and advisors, as this evidence destabilizes the original position.

This bias against new information without an objective reason is called the Semmelweis Reflex after the rejection by the colleagues of Dr. Ignaz Semmelweis of his suggestion of adopting the practice of handwashing between medical procedures. Semmelweis was eventually proved right, but not before his peers chose to uphold the then-popular belief that gentlemen's hands do not transmit contaminants or disease.

Examples are

- a tendency to reject an I.R.S. challenge of a stylized business model like "limited-risk distribution" or "contract service provider,"
- the discovery of authority to bind a foreign seller in a contract where this authority was posited not to exist,

---

[5] Treas. Reg. §1.482-1(d).

- the selection of an alternate transfer pricing method, or
- the choice of a different tested party if applying the Comparable Profits Method.

Likewise, the I.R.S.' paradigm of outbound intangible asset migration and undervaluation can be hard to displace with persuasive data that show foreign development effort and direction of technological development. U.S. parent organizations with highly decentralized management models are often challenged to convince the I.R.S. that service fees are not payable owing to the lack of benefit conferred or service delivered by U.S.-headquartered senior executives.

Companies and the I.R.S. can succumb to the Semmelweis Reflex because of widely-held beliefs. These beliefs can result from groupthink and the negative effects of diverging from common practice given a different fact pattern or new data becoming available. This tendency to take positions that have been adopted in previous cases by industry or I.R.S. peers or colleagues, can lead to entrenched positions and all-out defenses of positions for the sole reason that their adoption did not cause the investigator to stand out from a large or influential group of adopters. Taxpayer advisors can suffer from the same bandwagon bias, too.

The intent of transacting parties matters when characterizing a transaction, selecting a transfer pricing method, or assessing comparability. Outcome bias appears when a decision made at the beginning of a series of transactions is judged by the outcome of this decision (usually measured in terms of profitability) rather than the quality of the decision at the time it was made. This cognitive bias lies at the core of the I.R.S.' position on cost sharing and the commensurate with income standard.

Finding comparable data is not easy. Profit-based analysis using databases is a workable alternative to often elusive private company and transaction data. To apply the best method rule, all data and all methods must be considered and evaluated. The "law of the instrument" bias creeps in when the analyst instinctively assumes the comparable profits method ("C.P.M.") is the best method. The C.P.M. is widely used today to the point of over-reliance by less skilled analysts. This has the effect of ignoring or undervaluing alternative methods that may be good best-method candidates and leaving a position open to attack on examination. The old adage "if all you have is a hammer, everything looks like a nail" is one to keep in mind when selecting the best method.

If it is well known that finding comparable data is not easy, analysts and international tax planners may make recommendations of a best method under the influence of the well-travelled road effect. If it is believed that profit-based methods or other heuristics (the well-traveled road) always take less time and effort to determine, this may lead to the underestimation of the effort needed to apply these methods and the overestimation of the effort needed to apply alternative methods. This can lead to faulty best method conclusions and surprises on examination and during M&A deals when the well-traveled road suddenly collapses.

Lastly, one of my favorite transfer pricing cognitive slips is made when a transaction participant is described as having limited risk by virtue of the fixed-profit transfer pricing outcome that has been imposed. This is surrogation, which occurs when the analyst loses sight of the strategic construct – in this case, the risk borne by a company that participates in a controlled transaction. As a result, a profit level indicator

("P.L.I.") that is intended to represent a construct, itself, becomes the construct.[6]

TRANSFER PRICING HEURISTICS

Heuristics serve as "broad rules of thumb" and can be found to influence a company or the I.R.S.' position. A simple question replaces a more difficult question, and to the delight of the investigator, a simple answer is found. The trouble with the use of heuristics is that complex or unclear fact patterns make them unreliable. Have you ever wondered why you keep hearing any of the following transfer pricing chestnuts?

- Distributors earn an operating margin between two and five percent.
- Mark-ups seem to rise in increments of five percentage points.
- Selections of the tested party are all about being the "simplest" of two or more controlled taxpayers.
- An even 50/50 split of gross or residual profit is often the first guess.

An objective and thorough best method analysis may suggest that none of these heuristics should be used but the availability heuristic – an estimate based on what is more available in memory is difficult to work past, especially if vivid or emotionally charged examples come to mind. Spotting over-reliance on a heuristic early in the exam process can help to lead any controversy to the heart of the matter, push past entrenched positions using an objective application of the regulations, and reduce time and expense.

It is not uncommon to hear companies, their advisors, and tax authorities remark that a particular circumstance has been encountered before or looks familiar. Most people call this cumulative prior knowledge experience, but this information can also accumulate in a way that biases the judgement of an individual examining a transfer pricing position in the current period. Different from advising on a current matter using prior regulations as guidance, the representativeness heuristic can be unknowingly put to use here by judging the likelihood of the success of a transfer pricing position under exam on the basis of simple resemblance. We also know that matters can have different outcomes based on the examiner and the effects of personal interaction between the company and the I.R.S., but the temptation to judge a book by its cover can sometimes be strong and should be avoided.

It takes some discipline, professional skepticism and experience to recognize and work to mitigate the effects of cognitive bias. Awareness of the possible presence of various forms of cognitive bias is a positive first step.

DOCUMENTATION DISAPPOINTMENTS

Documentation prepared pursuant to Treas. Reg. §1.6662-6(d) serves as a company's chance to make a good first impression on the examiner, and to begin making the case for its position. As all positions are connected with a transaction or a series of transactions, and all methods should be applied at the transaction level to achieve the most reliable measure of an arm's length result, it follows that the explanation of the context and attributes of the transaction, and the functions and

[6] Treas. Reg. §1.482-1(d)(3)(iii)(B)(3).

risks inherent in the transaction should focus on the transaction. This is often not the case, and confusion arises as a result of written explanations of the broader business of the legal entity and the too-generalized characteristics and attributes of the broad industry classification. Similarly, inappropriate application of a transfer pricing method at the level of the legal entity or at a divisional level can frustrate the clear conveyance of the company's position or create latent error. With confusion comes misplaced factual assumptions that, if left unresolved, can result in a wedge between the company and the I.R.S.' positions.

"Pausing to think objectively about the cognitive biases, strengths, and weaknesses underlying a transfer pricing position is an essential step."

Transfer pricing documentation serves two purposes – it mitigates penalty risk under Code §6662(d) and it documents the company's reasoning for its selection of a transfer pricing method and demonstrates this method was applied reliably, resulting in the clear reflection of taxable income of the company. For practical reasons, companies often decide to produce documentation to meet only one of the two objectives. Companies often forget to reflect on the purpose of documentation before providing it to the I.R.S. in response to an I.D.R. Taking this step can often help identify future actions required to properly explain the factual or analytical underpinnings of a position and to ensure that these factors are taken into account by the I.R.S. throughout the course of the examination and are identified in the event that the case must be taken to Appeals, Tax Court, or Competent Authority for resolution. This step also helps to uncover certain biases that crept into the documentation and can be exposed under exam with employee interviews, information gathering, and analytical work undertaken for the purpose of verifying documented claims and positions.

IS YOUR METHOD THE BEST METHOD?

The best method rule is written as an explanation of a process of elimination using standard criteria. The documentation requirement concerning method selection is stated in two parts:[7] Companies must describe the method selected and explain why that method was selected, and also describe alternative methods that were considered and explain why these were not selected. While the first requirement is usually handled quite well in the standard accounting-firm style transfer pricing study, the second requirement is usually given only cursory treatment. If C.P.M. is shown to be the best method, it follows that all other methods are not the best method or are only of corroborative value. This approach may be found to beg the question. The company appears to have selected the best method without having carried out the best method analysis as required by the regulations.

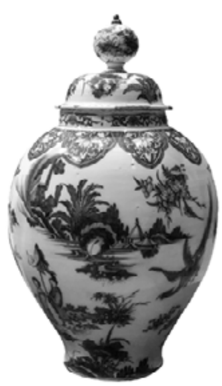
Pride of ownership and self-preservation can show through in debates about the best method or the application of the best method with the I.R.S. Though we expect that Insights subscribers are too busy reading to assemble their own modular furniture, some may appreciate the power of the "IKEA effect" as a cognitive bias. Just as people tend to overvalue items of IKEA furniture they have assembled themselves regardless of the quality of the end result, people associated with the selection or application of a transfer pricing method often appear to be proud owners of "dangerously leaning bookshelves." This tendency complicates the introduction of potentially informative corroborative analyses, and reasoned debate leading to an understandable conclusion to a transfer pricing examination, even when not fully agreed.

---

[7] Treas. Reg. §§1.6662-6(d)(2)(iii)(B)(4) and (5).

The question of who “owns” or is ultimately responsible for the position often arises. Company executives sign tax returns but may consider the advisor the owner of the position owing to the complexity of the subject matter or the limitations of his or her expertise. Advisors are often of the view that they can do little to maintain the position consistent with their conclusions if the I.R.S. takes an arbitrary or extreme view on a position. The I.R.S. often appears unaccountable for its position or cannot persuade the company or the advisor of the credibility or legality of its position – often “punting” the matter to Competent Authority or Appeals.

Pausing to think objectively about the cognitive biases, strengths, and weaknesses underlying a transfer pricing position is an essential step to take before delving into the technical aspects of the examination itself.



THE F-1 VISA – PRIVILEGED U.S. TAX STATUS AND HOW TO KEEP IT

Authors
Neha Rastogi
Beate Erwin

Tags
Exempt Individual
F-1 Visa
Foreign Students
Nonresident Alien

Foreign students leaving their home country and arriving in the U.S. for higher education may come across many things that seem alien to them – like the accent, culture, (inexplicably large) food portions, etc. But one area where they are treated as the aliens is under U.S. Federal income tax law. Foreign students who arrive in the U.S. on an F-1 visa (*i.e.*, student visa) are treated as nonresident aliens and subject to special tax provisions. This article discusses the residency status of foreign students on an F-1 visa, Federal income tax consequences, and U.S. reporting requirements.

FOREIGN STUDENTS ARE PER-SE NONRESIDENT ALIENS IN THE U.S.

An individual is treated as a U.S. resident if he or she meets either the "Green Card Test" or "Substantial Presence Test."[1]

1. **Green Card Test**

   An individual who holds a permanent resident card (more commonly known as a Green Card) is treated as a U.S. resident for Federal income tax purposes.[2]

2. **Substantial Presence Test**

   An individual who is neither a U.S. citizen nor a Green Card holder is treated as a U.S. resident if he or she satisfies the Substantial Presence Test. The Substantial Presence Test is satisfied for a relevant year if the following conditions are met:[3]

   a. The individual is present for at least 31 days in the relevant year.

   b. The number of days of presence in the U.S. in the relevant year and the two preceding years equals or exceeds a weighted aggregate of 183 days.

   For purposes of the weighted calculation, each day in the relevant year counts as one day, each day in the first preceding year counts as 1/3 of a day, and each day in the second preceding year counts as 1/6 of a day. An individual will be considered a resident alien under this test if he or she is present in the U.S. for 183 days or more in the relevant year.

---

1 Code §7701(b)(1)(A).

2 Code §7701(b)(1)(A)(i).

3 Code §7701(b)(3).

An individual who meets these requirements is treated as a U.S. resident and is therefore subject to U.S. Federal income tax on his or her worldwide income.

Foreign Students Are Exempt from the Substantial Presence Test

A foreign student's days of presence in the U.S. are not counted towards the Substantial Presence Test if the student qualifies as an exempt individual.[4] A foreign student will be treated as an exempt individual if the following conditions are satisfied:

- The foreign student is temporarily present in the U.S. under an F-1 visa.
- The foreign student substantially complies with the visa requirements.[5]

A foreign student will be deemed to comply substantially with the visa requirements if the individual has not engaged in activities that are prohibited by the Immigration and Nationality Act and the regulations thereunder and could result in the loss of F-1 visa status. Further, a foreign student will not be deemed to comply substantially with the visa requirements merely by showing that his or her visa has not been revoked.[6]

> **Example 1**
>
> If an individual with an F-1 visa is found to have accepted unauthorized employment or to have maintained a course of study that is not considered by the I.R.S. to be full-time, the individual will not be considered to comply substantially with the individual's visa requirements whether or not the individual's visa has been revoked.[7]

Thus, unless the student infringes his or her F-1 visa requirements, the foreign student will not establish tax residency in the U.S.

Exempt Individual Status Comes with an Expiration Date

A foreign student's exempt individual status remains in effect only for a specified period of time. He or she may exclude the days of presence in the U.S. for any part of five or fewer calendar years.[8] Notably, presence for as little as one day during a calendar year is treated as one full year. Further, the five-year period relates to the person's lifetime and need not be consecutive. In other words, once the five-year threshold is reached, a foreign person may never again qualify as an exempt student under this rule. An exception applies under the closer connection test for students ("Closer Connection Test")[9] described in the following section.

> **Example 2**
>
> Mr. A, an F-1 visa holder, has never been an exempt individual. He arrives

4 Code §7701(b)(3)(D)(i); Code §7701(b)(5)(A)(iii).

5 Code §7701(b)(5)(D)(i)-(ii); Treas. Reg. §301.7701(b)-3(b)(4).

6 Treas. Reg. §301.7701(b)-3(b)(6).

7 *Id.*

8 Code §7701(b)(5)(E)(ii).

9 To be distinguished from the general closer connection test that is not limited to students.

in the U.S. for the first time on December 31, 2017. The year 2017 will be counted as one full year even though Mr. A was present in the U.S. for just one day in the year. He must count 2017 as his first year of exempt individual status. For the next four years, his days of U.S. presence will be not be counted towards the Substantial Presence Test. Thus, Mr. A will be treated as an exempt individual for 2017, 2018, 2019, 2020, and 2021. Effective January 1, 2022, his exempt individual status will terminate, and Mr. A must begin counting days towards the Substantial Presence Test unless he meets the requirements under the Closer Connection Test.

"A foreign student may enjoy exempt individual status even after being present in the U.S. for any part of five calendar years."

In addition, days of presence in the U.S. as a trainee or a teacher (under a "J" or "Q" visa) are also included in the five-year period.[10]

Example 3

Mr. B is a citizen and resident of country A just prior to his arrival in the U.S. He arrives in the U.S. on August 15, 2013, as a researcher on a J-1 visa. Without leaving the U.S. he changes to F-1 visa status on August 10, 2014. His of presence in the U.S. under the J-1 visa will be included in the five-calendar-year period. Since Mr. B held his J-1 visa during 2013 and 2014, his status as an exempt individual under an F-1 visa can only continue through 2015, 2016, and 2017.

Five-Year Period May Be Extended if Closer Connection with Another Country Exists

A foreign student may enjoy exempt individual status even after being present in the U.S. for any part of five calendar years if it can be demonstrated to the satisfaction of the I.R.S. that he or she (i) does not intend to reside permanently in the U.S. and (ii) has substantially complied with the student visa requirements.[11] Deviating from the general closer connection exemption,[12] the Closer Connection Test for students does not provide for a 183-day threshold for the current year.

Whether an individual has demonstrated an intent to not reside permanently in the U.S. is based on the facts and circumstances, which include the following:[13]

- *Whether the Individual Has Maintained a Closer Connection with a Foreign Country*

  An individual is treated as having a closer connection to a foreign country than to the U.S. if the individual maintains more significant contacts with the foreign country.[14]

  The following factors that may be considered in making this determination:

  - The location of the individual's permanent home regardless of whether

---

[10] Treas. Reg. §301.7701(b)-3(b)(7)(iii). Special rules apply to teachers and trainees (Treas. Reg. §301.7701(b)-3(b)(7)(ii)).

[11] Code §7701(b)(5)(E)(ii); Treas. Reg. §301.7701(b)-3(b)(7)(iii).

[12] Code §§7701(b)(3)(B) and (C); Treas. Reg. §301.7701(b)-2.

[13] Treas. Reg. §301.7701(b)-3(b)(7)(iii).

[14] Treas. Reg. §301.7701(b)-2(d)(1).

the home is owned or rented[15]

- ○ The location of the individual’s family
- ○ The location of the individual’s personal belongings such as automobiles, furniture, clothing, and jewelry owned by the individual and his or her family
- ○ The location of social, political, cultural, or religious organizations with which the individual has a current relationship
- ○ The location where the individual conducts his or her routine personal banking activities
- ○ The location where the individual conducts business activities
- ○ The location of the jurisdiction in which the individual holds a driver’s license
- ○ The location of the jurisdiction in which the individual votes
- ○ The country of residence designated by the individual on forms and documents
- ○ The types of official forms and documents filed by the individual, such as Form 1078, *Certificate of Alien Claiming Residence in the U.S.*, Form W-8, *Certificate of Foreign Status*, or Form W-9, *Payer’s Request for Taxpayer Identification Number*

• *Whether the Individual Has Not Taken Affirmative Steps to Adjust the Individual’s Status from Nonimmigrant to Lawful Permanent Resident*[16]

An affirmative step to change an individual’s status to that of a permanent lawful resident includes the filing of certain forms with United States Citizenship and Immigration Services (“U.S.C.I.S.”), such as an application for a Green Card.[17]

In order to claim this exception, Form 8843, *Statement for Exempt Individuals and Individuals With a Medical Condition*, must be filed with the I.R.S. If filing a U.S. Federal income tax return, Form 8843 must be attached to the income tax return. Thus, if these requirements are met, the student will be treated as an exempt individual notwithstanding the fact that he or she has been present in the U.S. for five calendar years. Accordingly, days of presence in the U.S. after the expiration of the five-year period will not be counted toward the 183 days of presence under the Substantial Presence Test.

TAXATION OF FOREIGN STUDENTS IN THE U.S.

A foreign student who arrives in the U.S. on an F-1 visa (and meets other conditions

---

15 It is material that the dwelling is available at all times, continuously, and not solely for stays of short duration.

16 Treas. Reg. §301.7701(b)-3(b)(7)(iii)(B).

17 Treas. Reg. §301.7701-2(f).

discussed above) is treated as a nonresident alien for five calendar years, or more if the Closer Connection Test is satisfied. Thus, barring a few exceptions, a foreign student is taxed in the same manner as a nonresident alien for U.S. Federal income tax purposes. Broadly speaking, a foreign student is taxed only on certain U.S.-source income that is not connected with a U.S. trade or business, namely Fixed or Determinable, Annual or Periodic ("F.D.A.P.") Income,[18] and income that is effectively connected with a U.S. trade or business ("E.C.I").[19]

F.D.A.P. Income

F.D.A.P. Income includes U.S.-source dividends, certain interest, passive rents and royalties, non-qualified scholarships (see special rules below), compensation for services, and other "fixed or determinable, annual or periodical" income. Nonresident aliens, in general, – including students on an F-1 visa, in particular – who receive interest income from deposits with a U.S. bank, savings and loan institution, credit union, or insurance company, or who receive portfolio interest,[20] are exempt from taxation on this type of interest income as long as it is not effectively connected with a U.S. trade or business.

F.D.A.P. Income is taxed at a flat rate of 30% on gross income (*i.e.*, without any deduction or other allowance for costs incurred in earning the income). Tax is collected by means of withholding by the payor at the time of payment to the foreign student.[21] The 30% withholding tax may be reduced or eliminated under an applicable income tax treaty.

E.C.I.

When a nonresident alien engages in a trade or business in the U.S., all income from sources within the U.S. connected with the conduct of that trade or business is considered to be E.C.I. A nonresident alien who performs personal services in the U.S. is treated as being engaged in a U.S. trade or business.[22] Thus, a foreign student earning income by providing personal services in the U.S. will be treated as being engaged in a U.S. trade or business, and income earned therefrom will be treated as E.C.I. Such income is taxed on net basis (*i.e.*, after deduction of business expenses) at ordinary rates applicable to a U.S.-resident individual (ranging from 10% to 37% under current law).[23]

Do Not Forget the Tax Treaty

Typically, U.S. income tax treaties provide for an exemption from tax on income

---

[18] Code §871(a)(1).

[19] Code §871(b).

[20] Code §871(h). In order for a debt instrument to qualify as portfolio debt, *inter alia*, it must be in registered form both as to principal and interest. In addition, a certification on the payee's non-U.S. status (Form W-8) must be furnished to the withholding agent.

[21] Code §1441(a).

[22] Code §864(b).

[23] The income tax rates for individuals introduced under the 2017 Tax Cuts and Jobs Act are set to sunset end of 2025. Most recently, the administration indicated plans to make these changes permanent under a new bill expected for later in 2018.

earned by foreign students from the provision of personal services in the U.S. The income subject to exemption is usually limited to a dollar amount. Further, under most U.S. income tax treaties, the exemption is available for the first five years that the foreign student is present in the U.S.

Example 4

The U.S.-France Income Tax Treaty (the "Treaty") provides for an exemption on the first $5,000 earned by a French student from the provision of personal services in the U.S.[24] A French individual arriving in the U.S. on an F-1 visa will thus be eligible to this $5,000 exemption under the Treaty. Accordingly, if he or she works, for example, as an intern in a U.S. law firm and earns $50,000 in 2017, the first $5,000 will be exempt from U.S. Federal income tax under the Treaty. The French student will be subject to U.S. Federal income tax on the remainder (*i.e.*, $45,000).

Some Scholarships Are Taxed at a Reduced Rate of 14%

Typically, qualified scholarships received by an individual (whether or not a U.S. resident or citizen) are not subject to tax in the U.S. if the individual is a candidate for a degree at a qualified educational organization.[25] The term "qualified scholarship" is defined as any amount received by an individual as a scholarship granted for the payment of either (i) tuition and fees required for the enrollment or attendance at an educational organization or (ii) fees, books, supplies, and equipment required for courses of instruction at such an educational organization.[26]

In comparison, non-qualified scholarships (*i.e.*, amounts received for other expenses, such as room and board or travel) are not excludible from income.[27] The amount of non-qualified scholarship is subject to withholding tax at a reduced tax rate of 14%.[28] However, the benefit of the reduced tax rate is available only to nonresident alien students. A student who is either a U.S. resident or citizen receiving a non-qualified scholarship is subject to tax on the non-qualified scholarship at ordinary tax rates, (*i.e.*, 10% to 37% depending on the tax bracket applicable to the individual).

Foreign Students Are Exempt from Social Security and Medicare Taxes

A foreign student who qualifies as a nonresident alien and is temporarily present in the U.S. on an F-1 visa is exempt from Social Security and Medicare taxes on the wages received for personal services performed within the U.S. as long as these services are allowed by the U.S.C.I.S. and are performed in line with the purposes for which such visa was issued.[29]

Examples of personal services that are exempt from Social Security and Medicare Taxes under this rule include the following:

---

24 Article 21(b)(iii) of the U.S.-France Income Tax Treaty.

25 Code §117(a).

26 Code §117(b)(2).

27 U.S. Tax Guide for Aliens, Pub. 519 (Rev. February 28, 2018).

28 Code §§1441(a) and (b).

29 Code §3121(b)(19).

- On-campus student employment up to 20 hours per week (40 during summer vacations) (*e.g.*, working as a research assistant of a professor at the school)
- Optional Practical Training allowed by the U.S.C.I.S.

In line with the principles outlined in the foregoing, the exemption does not apply if the F-1 visa student changes his or her status to non-exempt or if becomes a resident alien.

REPORTING REQUIREMENTS

Foreign students have special reporting requirements for U.S. Federal income tax purposes. The thresholds which exempt U.S. citizens or resident aliens from filing up to a certain dollar amount do not apply to foreign students. Thus, a foreign student who earns taxable U.S.-source income is required to file an income tax return regardless of the dollar amount of the income.

Form 1040NR or Form 1040NR-EZ

A nonresident alien student who has the following income is required to file Form 1040NR or Form 1040NR-EZ, *U.S. Nonresident Alien Income Tax Return*:

- A taxable scholarship (as discussed above)
- Income partially or totally exempt from tax under the terms of a tax treaty
- Any other income that is taxable under the Code

"A foreign student who earns taxable U.S.-source income is required to file an income tax return regardless of the dollar amount of the income."

A nonresident alien student who has income only from the following sources is not required to file a U.S. income tax return:

- Income from foreign sources
- Interest income from[30]
    - U.S. banks,
    - U.S. savings and loan institutions,
    - U.S. credit unions, or
    - U.S. insurance companies
- Investments that generate portfolio interest
- A qualifying scholarship that is entirely tax free (as discussed above)

Form 8233 if Claiming Treaty Benefits for Personal Services

In addition to Form 1040NR or Form 1040NR-EZ, a nonresident alien student who earns income from providing personal services in the U.S. and claims exemption from tax under the relevant tax treaty shall also file Form 8233, *Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual*.

[30] Code §871(i).

Form 8833 if Claiming Treaty Benefits for Income Other than Income Earned from Providing Personal Services

A nonresident alien student who earns F.D.A.P. Income and claims a reduced tax rate under the applicable income tax treaty is required to report his or her treaty position by filing Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*, attached to his or her U.S. Federal income tax return.

Form 8316 for Refund of Social Security and Medicare Taxes

A nonresident alien student can file Form 8316, *Information Regarding Request for Refund of Social Security Tax Erroneously Withheld on Wages Received by a Nonresident Alien on an F, J, or M Type Visa*, to claim a refund of Social Security and Medicare taxes if erroneously withheld by the employer.

Form 8843 to Inform the I.R.S. About Exempt Individual Status

A foreign student is required to submit Form 8843, *Statement for Exempt Individuals and Individuals with a Medical Condition*, to explain to the I.R.S. the basis for excluding days of presence in the U.S. for purposes of the Substantial Presence Test as an exempt individual. This form must be filed by a nonresident alien student whether or not he or she is required to file a Federal income tax return in the U.S. Thus, this form must be filed even if the nonresident alien student does not earn any income in the U.S. Failure to file this form may prevent the foreign student from excluding the days of presence in the U.S. and can thus result in the student being treated as a U.S. resident under the Substantial Presence Test.

CONCLUSION

Foreign students coming to the U.S. for higher education belong to a special group of taxpayers. Firstly, they are taxed only on certain U.S.-source income. Secondly, they are offered exemption from Social Security and Medicare taxes and a lower tax rate on non-qualified scholarships. However, this only holds true as long as they maintain their nonresident status. In order to do so, it is of utmost importance that students are aware of rules on tax residency and comply with their filing obligations. As a starting point, upon their arrival in the U.S., students should begin working with the International Student Advisor at their school and, if a need arises, engage a U.S. tax professional to help navigate the maze of complex rules under U.S. tax law.

CORPORATE MATTERS:
PROFITS INTEREST BASICS

Author
Simon H. Prisk

Tags
Corporate Law
Employee Stock Ownership Plans ("E.S.O.P.")
L.L.C.
Partnership
Profits Interest

INTRODUCTION

In previous articles we have discussed the relative flexibility of limited liability companies ("L.L.C.'s"), which are generally taxed as partnerships, and their desirability for use in many instances, including joint ventures. Another demonstration of the flexibility of L.L.C.'s is in the area of incentive ownership interests. Often, when people think of incentive awards, it is in the context of C-corporations and stock option grants. We have found that in many instances, upon the formation of an L.L.C. to be used as a joint venture entity, the members (partners) want to set aside certain interests to be awarded to service providers or employees as incentives.

Business entities that are treated as partnerships for U.S. Federal income tax purposes do not qualify for certain statutory benefits that are available only to C-corporations and S-corporations; a business entity that is treated as a partnership for tax purposes cannot issue incentive stock options. However, a business entity that is treated as a partnership for tax purposes can often use a profits interest (*i.e.*, a share of future profits and appreciation but none of the existing value of the partnership) to achieve the same or better tax result for its holders.

WHAT IS A PROFITS INTEREST?

Partnership interests can be divided into capital interests and profits interests. A capital interest is a partnership interest that gives the owner the right to a share of proceeds if the partnership assets were sold at their fair market value and the proceeds distributed in a complete liquidation of the partnership. A profits interest is a partnership interest that gives the owner the right to receive a percentage of future profits (but not existing capital) from the partnership.

Most commonly, a profits interest is granted to a partner in exchange for a contribution of services. By contrast, a capital interest is typically granted to a partner in exchange for a contribution of cash or other property. Because some investor partners are also executives or senior managers, an investor partner may also be granted a separate profits interest in exchange for a contribution of services.

Unlike the owner of a capital interest, the owner of a profits interest has no current capital at risk in the venture and, usually, has no obligation to contribute funds in the future. Therefore, all that can be lost by the owner of a profits interest are profits earned after the grant date of the profits interest.

A profits interest can arise in many contexts, but its most common application is to align a service partner's economic interest with that of the business entity for which the services are provided. In the corporate context, stock options, restricted stock, statutory incentive stock options and phantom stock plans can be used to incentivize a service provider. In the partnership context a profits interest is by far the most common device.

WHO CAN GRANT A PROFITS INTEREST?

A profits interest can be granted by any entity that is treated as a partnership for U.S. Federal income tax purposes. This includes every business entity having two or more owners and not taxable as a corporation. These entities include general partnerships, limited partnerships, limited liability partnerships, limited liability limited partnerships and L.L.C.'s that have not made an election to be treated as a corporation for tax purposes.

If a limited liability company has a single owner, it is treated as a disregarded entity for U.S. Federal income tax purposes, unless it elects to be treated as a corporation for tax purposes. If a service provider is granted a profits interest in a disregarded entity, the creation of the profits interest automatically converts the disregarded entity into a partnership (for tax purposes) by virtue of the second ownership interest.

POSSIBLE ADVERSE CONSEQUENCES FOR EMPLOYEES

In addition to profits interests being granted to service providers, another common use for a profits interest is to grant a small profits interest in the partnership to a valued employee. The owner of a partnership interest cannot simultaneously be treated as an employee of the partnership. Therefore, if a profits interest is granted to an existing employee, what formerly was salary is converted into self-employment income. If the profits interest is small compared with the employee's annual salary, the burdens and costs of the profits interest grant may exceed the benefits. In such cases, alternate forms of compensation or alternate structures such as a tiered structure should be considered.

In a common tiered structure, a new partnership is formed, and it is given an ownership interest in the operating partnership. Profits interests in the upper-tier partnership are granted to employees or partners of the operating partnership. This tiered structure creates a formal division between the partnership for which the employee works and the partnership in which the employee is given a profits interest and so avoids potential adverse tax consequences for the employee. In addition, the owner of the profits interest does not necessarily have access to the operating partnership's records and in certain circumstances, this may be a desired result.

RIGHTS AND OBLIGATIONS OF OWNERS

It is important to remember that a profits interest is a partnership interest and therefore has all the rights and obligations that flow from having an ownership interest in the partnership. For example, if the partnership is formed as a general partnership, the owner of a profits interest is a general partner under applicable state law and is liable to creditors of the partnership despite anything in the partnership agreement to the contrary. For this reason, it is common to see profits interests limited to business entities offering limited liability protection.

In addition, the owner of a profits interest has whatever rights are provided by applicable state law to members of the partnership including, in many cases, the right to inspect the books and tax returns of the partnership. In the case of a small profits interest granted to incentivize a service partner, these ancillary rights can be more than the partnership wishes to grant. However, a tiered structure, referred to above, can be used to limit access to the records of the operating partnership.

TAX-FREE GRANTS

If structured properly, the I.R.S. has ruled that the contribution of services to a partnership in exchange for a profits interest is tax-free to the service partner and to the partnership at the time of grant and as it vests provided the following four requirements are satisfied:

1. The service partner must receive only a profits interest in the partnership in exchange for the contribution of services (*i.e.*, the service partner cannot be given a share of current capital in exchange for the contribution of services).
2. The profits interest must not relate to a "substantially certain and predictable stream of income" such as high-quality debt securities or a high-quality net lease of the partnership.
3. The service partner must not dispose of the partnership interest within two years of receipt of the interest.
4. The partnership must not be a "publicly traded partnership."[1]

Note that the first requirement (no interest in the partnership's current capital) means that if the partnership is liquidated immediately after the profits interest is granted, the owner of the profits interest would receive nothing. If, however, the partnership remains in existence and then turns a profit, the owner of the profits interest is entitled to a share of the profit earned since the date of grant.

If a service partner is granted a capital interest in exchange for a contribution of services, the service partner is taxed on the fair market value of the capital interest and there may also be tax consequences to the other partners and the partnership. For this reason, it is more common to grant a profits interest to a service partner.

Recent tax legislation has changed the treatment of certain profits interests. Prior to the change, recipients of profits interests generally realized long-term capital gain income. Under the new Code §1061, applicable to certain investment and real estate partnerships, a three-year holding period is now required to be eligible for long-term capital gains treatment.

[1] Rev. Proc. 93-27, 1993-2 C.B. 343 and Rev. Proc. 2001-43, 2001-2 C.B. 191.

FOREIGN INVESTOR IN A U.S. L.L.C. – HOW TO MINIMIZE WITHHOLDING TAX ON SALE OF L.L.C. INTEREST

Authors
Fanny Karaman
Stanley C. Ruchelman

Tags
Foreign Partners
L.L.C.
Withholding Tax

INTRODUCTION

On April 2, 2018, the I.R.S. published Notice 2018-29 (the "Notice"), describing Treasury Regulations it intends to issue with regard to the new withholding requirement on transfers of partnership interests by non-U.S. partners. This withholding requirement is codified under new Code §1446(f). While clarifying certain procedural aspects, the Notice also creates an unanticipated result in providing for the withholding of 100% of the sales proceeds when non-recourse liabilities are involved. Even if a refund request should ultimately reduce the U.S. income tax liability to the appropriate tax on the gain, this overwithholding may result in substantial cash-flow issues for foreign investors in U.S. partnerships, especially if a tax payment is due in the foreign investor's country of residence prior to the time of payment of the U.S. tax refund.

CODE §§864(C)(8) AND 1446(F)

Code §1446(f) was enacted on December 22, 2017, by Public Law 115-97 ("P.L. 115-97"). P.L. 115-97 also added new Code §864(c)(8). Both provisions are interrelated.

Code §864(c)(8) provides that gains or losses realized upon the direct or indirect disposition of a U.S. partnership interest by a non-U.S. partner generally constitute effectively connected income ("E.C.I.") to the extent that a fair-market-value sale by the partnership of all its assets would have generated effectively connected gain or loss in the hands of the transferor partner.

As a general rule, Code §1446(f) provides that if any gain on the disposition of a partnership interest is treated as E.C.I. pursuant to Code §864(c)(8), the transferee must withhold 10% of the amount realized on the sale. Here is the problem. The amount realized includes not only payments made by the purchaser but also the amount of the seller's distributive share of partnership debt. That share provided the selling partner with basis in the partnership interest at the time of acquisition or refinance. When that share of debt is eliminated as a result of the sale, the partner is considered to realize additional amounts in the sale.

The Notice provides that, pending further guidance by the I.R.S., a transferee of a non-publicly traded partnership interest must use the Foreign Investment in Real Property Tax Act ("F.I.R.P.T.A.") withholding principles for Code §1446(f) purposes, as modified by the Notice.

F.I.R.P.T.A. provides for withholding obligations when a non-U.S. person sells an interest in U.S. real property. Under both F.I.R.P.T.A. and Code §1446(f)(1), the withholding agent is generally the transferee.

The Notice further specifies that the transferee can use F.I.R.P.T.A. Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, and Form 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests*. The Notice also provides that the I.R.S. does not intend, for the moment, to issue withholding certificates similar to Form 8288-B, *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*. Further, in cases in which both F.I.R.P.T.A. withholding and Code §1446(f) withholding apply to the transfer of a partnership interest and the transferor has not obtained a withholding certificate requesting a reduced withholding amount under F.I.R.P.T.A., only the F.I.R.P.T.A. provisions apply.[1] If such a withholding certificate has been obtained, the transferee must withhold the higher of the F.I.R.P.T.A. withholding or the Code §1446(f)(1) withholding.

Compliance with one of these provisions is deemed compliance with the other provision. Note that the rate of F.I.R.P.T.A. withholding was increased to 15% in most instances effective after February 16, 2016.

AMOUNT REALIZED

The Notice focuses on two key elements for Code §1446(f) withholding purposes: the notion of "amount realized" and certain exceptions to the withholding requirement. As mentioned earlier, when partnership liabilities are involved, the withheld Code §1446(f)(1) amount can equal the entire sales proceeds.

"This cap on withholding benefits purchasers, not sellers."

As stated above, Code §1446(f) requires the transferee to withhold a 10% withholding tax on the amount realized by a foreign partner upon the sale of his or her U.S. partnership interest. The amount realized includes a reduction in the transferor's share of non-recourse partnership liabilities or other partnership liabilities to the extent the transferor partner is discharged from such liabilities.[2]

The Notice provides that if the amount required to be withheld exceeds the amount realized decreased by the transferor partner's share of partnership liabilities, the amount withheld equals the amount realized less the decrease in the transferor partner's share of partnership liabilities.[3] In other words, 100% of the sales proceeds could end up being withheld pursuant to the Notice.

Example 1

> A, a non-U.S. individual, sells his interest in U.S. partnership X for $5 million to B. A is not relieved from any partnership liabilities upon the sale. B must withhold $500,000 under Code §1446(f)(1).

Example 2

> Same as Example 1 but upon the sale of his interest in X, A is relieved from X liabilities in the amount of $50 million. The amount realized by A in this example is $55 million and B would have to withhold $5.5 million, which exceeds the cash portion of the sales proceeds. Pursuant to the Notice, the amount

---

1 Notice 2018-29, Section 10, referencing to the withholding certificate mentioned in the last sentence of Treas. Reg. §1.1445-11T(d)(1).

2 Treas. Reg. §1.752-1(h); Treas. Reg. §1.1001-2.

3 Section 8 of the Notice.

to be withheld in this example is limited to $5 million.[4] Thus, A's entire sales proceeds of $5 million would be withheld. It almost goes without saying that this cap on withholding benefits purchasers, not sellers.

Code §864(c)(8) treats gains or losses realized upon the direct or indirect disposition of a U.S. partnership interest by a non-U.S. partner as E.C.I. to the extent that a fair-market-value sale by the partnership of all its assets would have generated effectively connected gain or loss in the hands of the transferor partner. As explained, in determining the amount of gains and losses, a partner's share of partnership liabilities is included in the amount realized. But since the seller's basis also reflects such share, the effect of liabilities is generally netted out at the time the actual gain or loss is computed. The actual amount subject to U.S. taxation under Code §864(c)(8) would thus be lower than 100% of the sales proceeds withheld under Code §1446(f). The transferor partner would have to file a U.S. tax return requesting a refund of the difference between the amount withheld and the actual tax liability.

In addition to not having access to cash between the withholding event and the time of reimbursement, larger refund requests may go through a heavier internal refund process. For individuals, refund requests in excess of $2 million are subject to the Joint Committee on Taxation's staff refund review mechanism.[5] The threshold amount for C-corporations is $5 million. This only adds to the cash-flow issue.

WITHHOLDING EXCEPTIONS

Code §1446(f) and the Notice provide for several exceptions to the 10% withholding requirement.

Nonforeign Status Affidavit Provided by Transferor

Under Code §1446(f)(2), no withholding is required if the transferor furnishes a nonforeign affidavit to the transferee. Such affidavit must be signed under penalties of perjury and state the transferor's U.S. taxpayer identification number and the transferor's U.S. status. The Notice further states that the I.R.S. intends to issue regulations applying rules substantially similar to the F.I.R.P.T.A. nonforeign status certification rules. Under these rules, the nonforeign status affidavit must be furnished to the transferee prior to or at the time of the transfer.[6] Alternatively, the Notice provides that the transferor may use Form W-9, *Request for Taxpayer Identification Number and Certification,* for this purpose if certain conditions are met:

- The form includes the name and U.S. taxpayer identification number of the transferor.
- The form is signed and dated by the transferor.
- The jurat has not been deleted (*i.e.*, the affidavit is signed under penalties of perjury).

---

4 The amount realized of $55 million decreased by A's share of partnership liabilities of $50 million.

5 Joint Committee on Taxation, "Joint Committee Statutory Refund Review," February 18, 1970.

6 Treas. Reg. §1.1445-2(b)(2)(i); Section 6.01 of the Notice.

Pending further notice by the I.R.S., the nonforeign status affidavit does not need to be sent to the I.R.S.

No Gain Realized by Transferor

The Notice provides that regulations will be issued providing that if the transferor provides a certification to the transferee, stating that, under penalties of perjury, the transferor will not realize any gain on the transfer of the partnership interest, the transferee is relieved from its withholding obligation under Code §1446(f)(1). An example of an transaction in which no gain is realized is a gift of shares in a partnership that has no debt on its balance sheet.

Gain Realized but Not Recognized by Transferor

If the transferor realizes gain on the transfer but does not recognize such gain for income tax purposes pursuant to a nonrecognition provision of the Code or pursuant to the provisions of a U.S. treaty, the transferee may be exempt from its Code §1446(f)(1) withholding obligation. For this exception to apply, the transferor must provide a nonrecognition notice to the transferee. The content of the notice is based on F.I.R.P.T.A. nonrecognition notices under Treas. Reg. §1.1445-2(d)(2), as adjusted for purposes of Code §1446(f). Here again, the mailing of a copy of the notice to the I.R.S. is not required.

LESS THAN 25% E.C.T.I. OR LESS THAN 25% E.C.I. GAIN EXCEPTION

The Notice provides for two additional exceptions to the Code §1446(f) withholding obligation:

- The transferor certifies that for the transferor's prior taxable year and the two taxable years that precede it (the "Applicable Three-Year Period") the transferor was a partner in the partnership for the entirety of each of those years, and that the transferor's allocable share of effectively connected taxable income ("E.C.T.I.") for each of those taxable years was less than 25% of the transferor's total distributive share of income for that year (the "25% E.C.T.I. Exception").
- The partnership certifies that less than 25% of the total gain realized on a sale of all of its assets at fair market value would constitute E.C.I. gain (the "25% E.C.I. Gain Exception").

Under the 25% E.C.T.I. Exception, no withholding is required by the transferee if the following requirements are met:

- The transferor provides a certification to the transferee.
- The certification is signed under penalties of perjury and, to the extent required, contains the transferor's U.S. tax identification number.
- The certification is provided to the transferee no earlier than 30 days before the transfer.
- The certification provides that the transferor was a partner in the partnership for the entirety of the Applicable Three-Year Period.

For this purpose, the transferor's prior taxable year is the most recent taxable year of the transferor that includes the partnership taxable year that ends with or within the transferor's taxable year and for which both a Form 8805, *Foreign Parner's Information Statement of Section 1446 Withholding Tax*, and Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.*, were due (including extensions) or filed (if earlier) by the time of the transfer.

- The certification provides that for each of the years in the Applicable Three-Year Period, the transferor's allocable share of E.C.T.I. was less than 25% of the transferor's total distributive share of income for each year.

Under the 25% E.C.I. Gain Exception, no withholding is required under Code §1446(f)(1) if the following requirements are met:

- The partnership issues a certification to the transferee, signed under penalties of perjury.
- The certification states that if the partnership had sold all of its assets at their fair market value, the amount of gain that would have been E.C.I. would be less than 25% of the total gain. For this purpose, E.C.I. gain includes any F.I.R.P.T.A. gain under Code §897.
- The certification is provided to the transferee no earlier than 30 days before the transfer.

POTENTIAL SOLUTION

Since the Notice provides, *inter alia*, for an exception from Code §1446(f)(1) withholding when (i) the transferee receives a nonrecognition notice from the transferor or (ii) the transferee receives a nonforeign affidavit from the transferee, the following steps are suggested to provide a solution to the cash-flow issue. It does not, however, offer a solution to reduce the ultimate U.S. income tax liability on the sale.

- The non-U.S. partner contributes his partnership interest into a U.S. partnership, in exchange for an interest in such U.S. partnership. To the extent properly planned, this would constitute a nonrecognition transaction under Code §721. If the transferring partner provides a nonrecognition notice to the transferee partnership, no Code §1446(f)(1) withholding would apply. The capital account of the transferor would be booked up to fair market value, and the gain to that point would be entirely allocable to that partner.
- The U.S. transferee partnership would sell the transferred partnership interest. It would provide a nonforeign status affidavit to the acquirer and the acquirer would not have to withhold 10% of the amount realized under Code §1446(f)(1). The selling partnership would pay the equivalent of estimated tax to the I.R.S. on behalf of its foreign member(s) using the maximum tax set forth for the taxpayer based on its status as an individual or corporation with the gain that is allocable to the partners. The tax base would be computed by reference to the gain recognized by the partnership and allocated to each non-U.S. partner.[7]

---

[7] Code §1446(b).

Because the ultimate tax of the foreign partner would not be reduced by following the suggested plan, concepts such as step transaction, business purpose, and economic substance should not be relevant. The suggested plan merely aligns withholding tax to the ultimate tax on the gain, using the highest applicable rate for withholding tax purposes.

CONCLUSION

The new withholding tax rules can lead to severe overwithholding of tax when a foreign person holds U.S. business assets through a partnership or L.L.C. However, with planning there is an opportunity to significantly reduce the overwithholding to a manageable level. It is doubtful that the I.R.S. would ever consider this type of planning to be abusive.

"The effect of liabilities is generally netted out at the time the actual gain or loss is computed. The actual amount subject to U.S. taxation under Code §864(c)(8) would thus be lower than 100% of the sales proceeds withheld under Code §1446(f)."

I.R.S. ANNOUNCES SIX COMPLIANCE CAMPAIGNS

Author
Elizabeth V. Zanet

Tags
LB&I
Tax Compliance
Tax Treaties
Witholding Tax

The I.R.S. Large Business and International division ("LB&I") recently announced the approval of the following six additional compliance campaigns:

- Interest capitalization for self-constructed assets
- Non-compliance with respect to Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, and Form 3520-A, *Annual Information Return of Foreign Trust with U.S. Owner*
- Compliance with respect to Form 1042, *Annual Withholding Tax Return for U.S.-Source Income of Foreign Persons*, and Form 1042-S, *Foreign Person's U.S.-Source Income Subject to Withholding*
- Nonresident alien tax treaty exemptions
- Nonresident alien "Schedule A" and other deductions
- Nonresident alien individual tax credits

According to the announcement, the decision to approve these compliance campaigns is the result of LB&I data analysis and suggestions from I.R.S. employees. As discussed below, the compliance campaigns will use various methods, including examinations and statutory penalty assesments, as well as less direct methods such as education and outreach. Notably, all but one of the campaigns relate to international compliance.

INTEREST CAPITALIZATION FOR SELF-CONSTRUCTED ASSETS

Code §263A denies deductibility for certain direct and indirect costs incurred with respect to property. Such costs must be capitalized (*i.e.*, added to the tax basis of the property) and utilized as depreciation or amortization deductions over the useful life of the property. Property subject to Code §263A capitalization includes real property and tangible personal property produced by the taxpayer (*e.g.*, certain costs incurred by a builder in constructing homes). Under certain circumstances, interest expense must be capitalized under Code §263A. Interest expense capitalization applies to interest a taxpayer pays or incurs during the production period when producing property that meets the definition of designated property. Designated property means (i) any real property, or (ii) tangible personal property that has (a) a long useful life (depreciable class life of 20 years or more), (b) an estimated production period exceeding two years, or (c) an estimated production period exceeding one year and an estimated cost exceeding $1,000,000.

This campaign will use examinations, letters, and taxpayer education to improve compliance. The focus will be placed on verifying that interest is properly capitalized for designated property and the computation to capitalize that interest is accurate.

NON-COMPLIANCE WITH RESPECT TO FORMS 3520 AND 3520-A

Forms 3520 and 3520-A are information returns used to report information on transactions with certain foreign trusts and gifts received from foreign persons (in the case of Form 3520) and foreign trusts with U.S. owners (in the case of Form 3520-A). As with other information returns pertaining to cross-border transactions, the penalties for late or incomplete filing of Forms 3520 and 3520-A are significant.

The announcement states that this campaign will focus on examinations and penalty assessments. However, this would seem to be counter productive if the persons penalized are those who voluntarily file Form 3520 late as a result of upgrading the quality of tax advisers. The penalties can be severe, being the greater of $10,000 or the amount listed in the following table.

Non-compliance Item	Penalty
Failure to report the creation of or transfer to a foreign trust	35% of the gross value of any property transferred by U.S. person
Failure to report receipt of the distribution from a foreign trust	35% of the gross value of the distributions received by U.S. person
Failure to report required information on assets treated as owned by U.S. person under the grantor trust rules	5% of the gross value of all foreign trust assets
Failure to report a foreign gift or bequest, or filing an incorrect or incomplete form	5% of the gift or bequest for each month during which the failure continues, up to a maximum of 25%

COMPLIANCE WITH RESPECT TO FORMS 1042 AND 1042-S

Taxpayers who make payments of certain U.S.-source income to foreign persons (*e.g.*, payments of interest, dividends, rents, or royalties) must comply with the related withholding, deposit, and reporting requirements. The compliance of withholding agents is the only practical manner by which to collect withholding taxes from foreign persons. This campaign addresses withholding agents who make payments but do not meet all of their compliance duties. The announcement suggests that the primary method to be used in this campaign will be examinations.

Notably, this campaign is concerned with compliance duties other than paying withholding taxes. Such duties may include filing Forms 1042 and 1042-S completely and correctly, sometimes done to obscure the recipient in the country of residence. This is especially the case since foreign tax identification numbers are now required.

NONRESIDENT ALIEN TAX TREATY EXEMPTIONS

Income tax treaties provide benefits to nonresident aliens (*i.e.*, foreign individuals who are neither U.S. citizens nor residents) such as lower withholding tax rates and the exemption of certain income from U.S. Federal income tax. This campaign is intended to increase compliance in claiming tax treaty exemptions for nonresident aliens related to income effectively connected to a U.S. trade or business and a certain investment-type income known as Fixed, Determinable, Annual, or Periodic ("F.D.A.P.") income.

The announcement states that some nonresident alien taxpayers (i) incorrectly interpret and apply treaty benefits, (ii) provide incorrect or incomplete forms to the withholding agents, or (iii) rely on incorrect information returns provided by U.S. payors to improperly claim treaty benefits. The I.R.S. will implement this campaign through a variety of methods, including outreach, education, and examinations. Again, this is an issue where non-compliance is addressed to exchange of information with tax authorities in the taxpayer's country of residence.

NONRESIDENT ALIEN "SCHEDULE A" AND OTHER DEDUCTIONS

This campaign is intended to increase compliance in the proper deduction of eligible expenses by nonresident aliens on Form 1040NR, *Nonresident Alien Income Tax Return*, Schedule A (Itemized Deductions).

The Tax Cuts and Jobs Act of 2017 ("T.C.J.A.") introduced significant changes to the rules regarding itemized deductions. In general, itemized deductions have been significantly reduced or eliminated under the T.C.J.A.

According to the I.R.S., some nonresident aliens either (i) misunderstand or misinterpret the rules for allowable deductions, (ii) do not meet all the qualifications for claiming the deduction, or (iii) do not maintain proper records to substantiate the expenses. Presumably, the new law will create more compliance issues.

The I.R.S. will implement this campaign through a variety of methods, including outreach, education, and examinations.

NONRESIDENT ALIEN INDIVIDUAL TAX CREDITS

The Code provides numerous tax credits for individual taxpayers. Individual tax credits are available under a variety of circumstances, including paying expenses for education and maintaining children or other dependents. This campaign is intended to increase the compliance of nonresident aliens with respect to individual tax credits. Nonresident aliens who (i) have no qualifying earned income, (ii) do not provide substantiation or proper documentation, or (iii) do not have qualifying dependents may erroneously claim certain dependent-related tax credits. Furthermore, some nonresident aliens claim education credits, which are only available to U.S. citizens or residents.

The I.R.S. will implement this campaign through a variety of methods, including outreach, education, and examinations.

Authors
Rusudan Shervashidze
Nina Krauthamer

Tags
Cryptocurrency
Form W-8BEN
FinCen
I.C.O.
I.R.S.
Nonresidents
Phishing

LIMITED RELIEF FOR TRANSITION TAX

In IR-2018-131, issued on June 4, 2018, the I.R.S. announced that it will waive certain late-payment penalties relating to the Code §965 transition tax and provided additional information for individuals subject to the transition tax regarding the due date for relevant elections.

The I.R.S. explained the relief in three new F.A.Q.'s, posted on the agency's tax reform page. These supplement 14 existing questions and answers that provide detailed guidance to taxpayers on reporting and paying the tax.

Code §965, enacted in December 2017, imposes a tax on previously untaxed earnings of foreign corporations owned by "U.S. Shareholders" of controlled foreign corporations and U.S. domestic corporations that were entitled to claim indirect foreign tax credits for foreign taxes paid by foreign corporations at the time dividends were received.

Under the transition tax, foreign earnings held in the form of cash and cash equivalents by those foreign corporations are included in income by their U.S. Shareholders or domestic corporations and are taxed at a 15.5% rate. Any earnings in excess of such cash and cash equivalents are taxed at an 8% rate. The transition tax generally may be paid in installments over an eight-year period when a taxpayer files a timely election under Code §965(h).

The newly issued F.A.Q.'s provide as follows:

- In some instances, the I.R.S. will waive the estimated tax penalty for taxpayers subject to the transition tax who improperly attempted to apply a 2017 calculated overpayment to their 2018 estimated tax, as long as they make all required estimated tax payments by June 15, 2018.
- For individual taxpayers who missed the April 18, 2018, deadline for making the first of the eight annual installment payments, the I.R.S. will waive the late-payment penalty if the installment is paid in full by April 15, 2019. Absent this relief, a taxpayer's remaining installments over the eight-year period would have become due immediately. This relief is only available if the individual's total transition tax liability is less than $1 million. Interest will still be due. Later deadlines apply to certain individuals who live and work outside the U.S.
- Individuals who have already filed a 2017 return without electing to pay the transition tax in eight annual installments can still make the election by filing a 2017 Form 1040X with the I.R.S. The amended Form 1040 generally must be filed by October 15, 2018.

TAX PHISHING SAGA – NEW TWIST TO FAKE I.R.S. CALLS

While taxpayers are catching on to scam artists that pretend to be I.R.S. agents, the scammers themselves are coming up with a new twist on an old phone scam to scare taxpayers into paying non-existent tax bills. To update taxpayers on this new twist, on April 24, 2018, the I.R.S. issued IR-2008-103 advising taxpayers to stay alert to tax scams.

In the latest scheme, scam artists are claiming to call from a local I.R.S. Taxpayer Assistance Center ("T.A.C.") office and demand a tax payment. They have programmed their computers to display the T.A.C. telephone number, which appears on the taxpayer's caller I.D. when the call is made. If the taxpayer refuses to pay, the scam artist directs the taxpayer to www.IRS.gov to look up the local T.A.C. office telephone number to verify the phone number.

Once the taxpayer has had time to verify the call number, the scam artist calls back. When calling the second time, the scam artist again fakes or "spoofs" the caller I.D. to make it appear as though the I.R.S. office is calling. Once they have convinced the taxpayer that the call is coming from the I.R.S., they continue to demand payment, generally requesting payment through a debit card.

Taxpayers should be aware:

- **I.R.S. employees at T.A.C. offices do not make calls to taxpayers demanding payment of overdue tax bills.** I.R.S. agents usually communicate through mail that is delivered by the U.S. Postal Service.

- **There are limited circumstances in which an I.R.S. agent does an in-person investigation.** Even then, it is conducted after the taxpayer is informed about an I.R.S. inquiry by notice letter.

- **The I.R.S. does not demand that you use a specific payment method, such as a prepaid debit card, gift card, or wire transfer.** The I.R.S. will not ask for your debit or credit card numbers over the phone. If you owe taxes, payments should be directed to the U.S. Treasury or review www.IRS.gov/payments for I.R.S. online options.

- **The I.R.S. does not demand that you pay taxes without the opportunity to question or appeal the amount they say you owe.** Generally, the I.R.S. will first mail you a bill if you owe any taxes. You should also be advised of your rights as a taxpayer.

- **The I.R.S. will not threaten to bring in local police, immigration officers, or other law enforcement to arrest taxpayers for nonpayment.** The I.R.S. also cannot revoke your driver's license, business licenses, or immigration status. Such threats like these are common tactics scam artists use to trick victims into buying into their schemes.

Taxpayers who receive a scam I.R.S. phone call should report it to the Treasury Inspector General for Tax Administration by emailing phishing@irs.gov with the subject line "I.R.S. Phone Scam."

ENHANCED PHISHING TACTICS – BEWARE FORM 8-WBEN

I.R.S. phishing scams have evolved into a new racket in which phony I.R.S. agents target non-U.S. residents to solicit detailed personal identification and bank account information.

Unlike phone calls used in previous scams, in this case, the fake I.R.S. agents fax or mail a letter representing that, although individuals are exempt from withholding and reporting income tax, they still need to authenticate their information by filling out a phony version of Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting*. Recipients of these scam letters are requested to fax the information back.

Generally, Form W-8 is used by nonresident individuals and foreign businesses to certify their foreign status when they have U.S.-source income. The form informs the U.S. payor that the receiver is not subject to the usual tax withholding in the U.S. and it is submitted to the withholding agent.

According to the I.R.S., this is not the first-time nonresidents have been targeted by fake I.R.S. agents seeking personal details such as passport numbers and PIN codes. The legitimate I.R.S. Form W-8BEN does not ask for any of that information. The phony letter or fax also refers to Form W9095, which does not exist. Furthermore, the I.R.S. does not require a recertification of foreign status.

Nonresidents should be vigilant of bogus letters and emails that appear to come from the I.R.S. or other tax professionals. Scam letters, forms, and e-mails are designed to trick taxpayers into thinking these are official communications from the I.R.S. or others in the tax industry, including tax software companies. These phishing schemes may seek personal information including mother's maiden name, passport, and other account information in order to steal the victim's identity and their assets.

If you believe that you are a victim of a scam, please report it to the I.R.S. Impersonation Scam Reporting site or email phishing@irs.gov with the subject line, "I.R.S. Impersonation Scam."

FINCEN: MONEY TRANSMITTER RULES APPLY TO I.C.O.'S

There is still no general consensus on what virtual (crypto) currency is; the I.R.S. treats it as a property, while the Financial Crimes Enforcement Network ("FinCEN") sees it "a medium of exchange that operates like a currency."

In a letter dated February 13, 2018, to Senator Ron Wyden (D-O.R.) FinCEN's assistant secretary for legislative affairs, Drew Maloney, explained the network's position on convertible virtual currency including I.C.O.'s (initial coin offerings). According to the letter:

> Under existing regulations and interpretations, a developer that sells convertible virtual currency, including in the form of ICO coins or

> tokens, in exchange for another type of value that substitutes for currency is a money transmitter and must comply with AML/CFT (anti-money laundering/combating the financing of terrorism) requirements that apply to this type of MSB (money services business). An exchange that sells ICO coins or tokens, or exchanges them for other virtual currency, fiat currency, or other value that substitutes for currency, would typically also be a money transmitter.[1]

This indicates that both developers and exchangers involved in an I.C.O. could be treated as money transmitters and may be required to register as such to comply with the relevant statutes around anti-money laundering and know-your-customer ("K.Y.C.") rules. This could mean that a group conducting an I.C.O. that has U.S. clients may have to register with FinCEN as a money transmitter and follow the K.Y.C. regulations.

"Developers and exchangers involved in an I.C.O. could be treated as money transmitters and may be required to register as such to comply with the relevant statutes around anti-money laundering and K.Y.C. rules."

The obligation to meet anti-money laundering/combating the financing of terrorism ("A.M.L./C.F.T.") requirements to participate in an I.C.O. depends on the nature of the financial activity involved and the facts and circumstances of each case. Token sales structured as sales of securities or derivatives would fall under the U.S. Securities and Exchange Commission ("S.E.C.") or the Commodity Futures Trading Commission ("C.F.T.C.") regulations, respectively.

FinCEN, along with Office of Terrorism and Financial Intelligence ("T.F.I.") has worked diligently to ensure that A.M.L./C.F.T. rules apply to virtual currency exchangers and administrators that are in the U.S. or conduct business within the U.S., even if they do not have a physical presence in the country. FinCEN maintains a team of analysts that proactively review the Bank Secrecy Act filings to identify trends and risks for money laundering and other financial crimes and provide this information to other U.S. law enforcement and other government agencies, including the S.E.C. and C.F.T.C.

---

1 Letter from Drew Maloney, FinCEN's assistant secretary for legislative affairs, dated February 3, 2018.

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

Contacts

If you have any questions regarding this publication, please contact the authors or one of the following members.

NEW YORK

150 EAST 58TH STREET, 22ND FLOOR, NEW YORK, NY 10155

Galia Antebi	antebi@ruchelaw.com	+1 212.755.3333 x 113
Beate Erwin	erwin@ruchelaw.com	+1 212.755.3333 x 116
Fanny Karaman	karaman@ruchelaw.com	+1 212.755.3333 x 127
Nina Krauthamer	krauthamer@ruchelaw.com	+1 212.755.3333 x 118
Jennifer Lapper	lapper@ruchelaw.com	+1 212.755.3333 x 124
Andrew P. Mitchel	mitchel@ruchelaw.com	+1 212.755.3333 x 122
Simon H. Prisk	prisk@ruchelaw.com	+1 212.755.3333 x 114
Neha Rastogi	rastogi@ruchelaw.com	+1 212.755.3333 x 131
Stanley C. Ruchelman	ruchelman@ruchelaw.com	+1 212.755.3333 x 111
Sheryl Shah	shah@ruchelaw.com	+1 212.755.3333 x 112
Rusudan Shervashidze	shervashidze@ruchelaw.com	+1 212.755.3333 x 117
Francesca York	york@ruchelaw.com	+1 212.755.3333 x 125
Elizabeth V. Zanet	zanet@ruchelaw.com	+1 212.755.3333 x 123

TORONTO

130 KING STREET WEST, SUITE 2300, TORONTO, ON M5X 1C8

Michael Peggs	peggs@ruchelaw.com	+1 212.755.3333 x 232

Editorial Staff

Jennifer Lapper .... Managing Editor, Art Director
Francesca York .... Graphics Editor
Brandon Shirazi ....Copyeditor

PHOTOS IN THIS ISSUE WERE TAKEN BY:
Galia Antebi, Jennifer Lapper, Simon Prisk, Stanley C. Ruchelman, and Francesca York.