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INSIGHTS

INVOKING M.F.N. CLAUSE UNDER INDIAN TAX TREATIES REQUIRES NOTIFICATION

NEWS FROM ITALY – RECENT UPDATES TO INBOUND WORKERS REGIME AND REGISTER OF BENEFICIAL OWNERS

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AND MORE

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About Us

EDITORS' NOTE

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

- **Invoking M.F.N. Clause Under Indian Tax Treaties Requires Notification.** India's tax treaties with various countries mitigate double taxation and reduce the scope of taxable income or provide lower rates of withholding tax in certain cases. Some agreements include a most favoured nation ("M.F.N.") clause. The clause allows the treaty partner country to import benefits from a subsequently signed Indian income tax treaty when certain conditions are met, most notably that the treaty partner country in the treaty subsequently signed is a member of the O.E.C.D. Opinions differed as to whether the M.F.N. clause is self-executing when a treaty partner country was not a member of the O.E.C.D. at the time its treaty with India is negotiated but subsequently becomes a member. Does the M.F.N. clause apply automatically or are there procedures to follow? Recently, the Supreme Court of India upheld the position of Indian tax authorities that an M.F.N. clause is not self-executing and that an M.F.N. clause properly looks only to the list of O.E.C.D. member states at the time the earlier treaty was signed. Sakate Khaitan, the Senior Partner of Khaitan Legal Associates, Mumbai, Abbas Jaorawala, a Senior Director and Head-Direct Tax of Khaitan Legal Associates, Mumbai, and Weindrila Sen, an associate of Khaitan Legal Associates, Mumbai explain all. Indian subsidiaries now face the risk of taxation, interest, and penalties for the past 10 years.

- **News From Italy – Recent Updates to Inbound Workers Regime and Register of Beneficial Owners**. This month, the good news regarding special tax regimes in Italy relates to the flat tax. No changes are expected to the regime as Italy finishes its legislative session. The €100,000 flat tax remains intact. Good news also exists for the lesser known Pensioners Regime that imposes a 7% substitute tax on all pension payments paid on non-Italian source pension income if certain conditions are met. However, cutbacks in benefits and more stringent standards for qualification have been announced regarding the Inbound Workers Regime. In addition, the Register of Beneficial Owners of enterprises with legal personality, private legal entities, trusts, and similar legal arrangements has become operational at local Italian Chamber of Commerce offices. Andrea Tavecchio, the Founder and Senior Partner of Tavecchio & Associati, Tax Advisers, Milan, and Alessandro Carovigno, a chartered accountant at Tavecchio & Associati, Tax Advisers, Milan, explain the revisions to the Inbound Workers Regime and the information that must be filed with the Beneficial Owner Register. They also address the persons obligated to file with the Register and the persons who have access to the information filed with the Register.

- **Entering a New Dimension – O.E.C.D. Transfer Pricing Guidance as Hard Tax Law.** Except for the U.S., transfer pricing law frequently includes a provision that references the O.E.C.D. T.P. Guidelines as the guidance that must be used to interpret other provisions of relevant law. Nonetheless, national tax administrations publish their own interpretive guides to the O.E.C.D. T.P. Guidelines, thereby adding to a body of administrative guidance that can vary from country to country. The European Commission has recently proposed a Council Directive on transfer pricing released as part of the Business in

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Europe: Framework for Income Taxation ("B.E.F.I.T."). The Directive proposes to codify the arm's length principle and elements of its interpretation from the O.E.C.D. T.P. Guidelines. This elevates the O.E.C.D. T.P. Guidelines into E.U. law, thereby making them more than an arm's length principle interpretive standard. It does so with several subtle and not-so-subtle variations. Michael Peggs and Michael Bennett caution that making soft law into hard law impairs the ability of tax administrations to compromise on points of controversy.

- **Profits and Carryover Losses in a C.F.C. – Can Those Losses Offset G.I.L.T.I. Tax On Gain.** Forward-looking tax planning for U.S. taxpayers and their foreign subsidiaries was never an easy task. Since the adoption of the G.I.L.T.I. regime, domestic tax plans must be adjusted when applied to a cross border scenario. In their article, Stanley C. Ruchelman and Neha Rastogi examine a straightforward merger of related corporations, each operating at a loss, followed by a significant gain from the sale of an operating asset. What is a statutory merger when two companies are based outside the U.S.? What information must be reported on a U.S. Shareholder's U.S. income tax return? What forms are used to report the information? Do the G.I.L.T.I. rules make operating losses of a C.F.C. useless to a U.S. Shareholder when a C.F.C. sells operating assets at a sizable gain? These and other issues are explored by the authors.

- ***Moore v. U.S.* – A Case for the Ages to be Decided by Supreme Court.** *Moore v. U.S.* is a case that asks the following question: does the U.S. Constitution impose any limitations on Congress to impose tax where no Subpart F income is realized during the year by a C.F.C. and no dividends have been paid to shareholders? It does so in the context of the change in U.S. tax law provisions designed to avoid double taxation of income in a cross border context. Prior to 2018, U.S. law eliminated double taxation on direct investment income of a U.S. corporation by allowing an indirect foreign tax credit for income taxes paid by a ≥10%-owned foreign corporation. In 2018, the U.S. scrapped that method and adopted a D.R.D. for dividends paid to a U.S. corporation by a ≥10%-owned foreign corporation. To ensure that accumulated profits in the foreign corporation at the time of transition would be taxed under the old system, the transition tax required a one-time increase in Subpart F income attributable to the deferred foreign earnings of certain U.S. shareholders. However, the tax was imposed in certain circumstances on individuals who never were entitled to claim an indirect foreign tax credit under the old law and were not eligible to claim the benefit of the D.R.D. Mr. and Mrs. Moore were two such individuals. They paid the transition tax, filed a claim for refund, and brought suit in the U.S. Federal District Court to recover the tax paid. They lost in the district court and again on appeal. A writ of *certiorari* was filed with the U.S. Supreme Court and the case was accepted for consideration. Most pundits believe the Moores have no chance of winning. Stanley C. Ruchelman and Wooyoung Lee evaluate their chances, pointing out that the last chapter of the saga has not yet been written.

- ***Christensen v. U.S.* – Reducing the N.I.I.T. by Claiming an F.T.C.** In *Christensen*, the Federal Claims Court allowed U.S. citizen/French tax resident taxpayers to claim the foreign tax credit to reduce the net investment income tax ("N.I.I.T.") using Article 24(2)(b) of the France-U.S. Income Tax Treaty. This approach countered the Code's explicit disallowance of the foreign tax

credit as a way to reduce the N.I.I.T. The Federal Claims Court decision built upon the Tax Court's previous decision in *Toulouse*, where the Tax Court denied the foreign tax credit claimed against the N.I.I.T. by a U.S. citizen/French resident taxpayer. Michael Bennett explains that the disparity in outcomes did not stem from a conflict in reasoning. Rather, it resulted from the application of different provisions of the treaty.

- **Updates & Other Tidbits: F.B.A.R. Case, Taiwan Tax Treaty, C.T.A. Extension of 2024 Filing Deadline.** This month, Wooyoung Lee looks at several interesting items, including (i) *Aroeste v. U.S*, an F.B.A.R. case that will bring joy to many expat green card holders living abroad and claiming U.S. tax benefits as a resident of a treaty partner country, (ii) continued movement towards passage of the Taiwan tax-treaty bill, reflecting bipartisan support in the Senate and House of Representatives, and (iii) the issuance by FinCEN of final regulations allowing a 90-day period for filing beneficial owner statements for companies formed in 2024.

We hope you enjoy this issue.

- The Editors

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INVOKING M.F.N. CLAUSE UNDER INDIAN TAX TREATIES REQUIRES NOTIFICATION

Authors
Sakate Khaitan
Abbas Jaorawala
Weindrila Sen

Tags
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D.D.T.
India
M.F.N.
Nestle
Steria
T.D.S.

Sakate Khaitan is the senior partner of Khaitan Legal Associates, Mumbai. He heads the corporate M&A, funds, restructuring and insurance practice. He has extensive experience working with Indian and foreign companies, H.N.W. individuals and government authorities.

Abbas Jaorawala is a Senior Director and Head-Direct Tax of Khaitan Legal Associates, Mumbai. He has extensive experience in advising on domestic and cross border direct tax matters and Indian exchange control regulations.

Weindrila Sen is an associate of Khaitan Legal Associates, Mumbai.

BACKGROUND

Foreign investment in Indian businesses increased significantly since the liberalization measures adopted by the Indian government in the early 1990s. Taxation played an essential role in attracting foreign investment during this period. One change made effective from April 1, 2020, was the elimination of the dividend distribution tax (the "D.D.T."). Prior to this date, dividends distributed by an Indian company were exempt from tax in India in the hands of shareholders. However, the Indian company making a distribution paid D.D.T. on the amount distributed. Effective from April 1, 2020, the concept of D.D.T. was abolished, and dividend income became taxable in the hands of shareholders.

T.D.S.

Indian companies are now required to withhold tax at source ("T.D.S.") when distributing dividends to shareholders. For dividends paid to non-resident shareholders, the rate of T.D.S. imposed under the Income-tax Act 1961 ("Act") is 20%, plus applicable surcharge and cess. A non-resident shareholder can benefit from a lower tax rate under an applicable income tax treaty. For a non-resident shareholder to claim income tax treaty benefits in India, it must furnish a tax residency certificate from its country of tax residence, along with other prescribed documentation. In addition, a non-resident shareholder must demonstrate commercial substance in its country of tax residence. In addition, it must demonstrate that the principal purpose of claiming the income tax treaty benefit is not tax evasion or tax avoidance.

Withholding Tax and M.F.N.

India's tax treaties with various countries mitigate double taxation and also reduce the scope of taxable income or lower the rate of tax in certain cases. The protocols of some of India's tax treaties include a clause known popularly as a most favoured nation ("M.F.N.") clause.

In principle, an M.F.N. clause allows the treaty partner country to import benefits from a subsequently signed Indian income tax treaty when certain conditions are met. To illustrate, India's tax treaties with the Netherlands, France, Switzerland, Spain, and several other countries allow for the application of a lower withholding tax rate in India where an income tax treaty signed by India enters into force at a later date and provides for a lower rate of Indian withholding tax or a reduced scope of taxable income, provided the treaty partner country is a member of the Organization for Economic Cooperation and Development ("O.E.C.D."). The wording of an M.F.N. clause may differ from treaty to treaty. However, a plain reading of a typical M.F.N. clause would suggest that once an income tax treaty comes into effect at a later date with another O.E.C.D. member country providing for a lower rate of withholding tax

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on an item of income or a reduced scope of taxable income, the M.F.N. provisions in earlier treaties will apply without further action, unless negotiation is specifically called for in a particular treaty. An example is the India-Switzerland Income Tax Treaty.

However, the invocation of an M.F.N. clause without further negotiation as to the reduction of withholding tax has not been straightforward in India. Rather, it has been debated over the years across various regions and forums in India. Depending on the relevant facts, authorities have taken divergent views on whether a protocol containing the M.F.N. clause forms part of the income tax treaty itself or applies automatically without any specific notification by the tax authorities. Also debated is whether an income tax treaty negotiated with a country that is not a member of the O.E.C.D. ("non-member country") automatically becomes an income tax treaty that can trigger the application of the M.F.N. clause in another treaty when the non-member country with the lower withholding tax rate becomes a member of the O.E.C.D.

DEFINITIVE SUPREME COURT DECISION

The issue was settled recently by the Supreme Court of India in its much awaited judgment in the matter of *Assessing Officer Circle (International Taxation) 2(2)(2) New Delhi v. M/s Nestle SA*.[1] The judgment of the Supreme Court is binding across India and is the law of the land.

In the case, the Supreme Court was asked to clarify the following two issues:

- Does the M.F.N. clause apply automatically, or does it come into effect only after notice by the Indian authorities?
- Does the M.F.N. clause in income tax treaties with countries such as the Netherlands, France, Switzerland, and Spain apply automatically when India's treaty partner is a non-member country that becomes an O.E.C.D. member at a subsequent point in time?

In this case, the M.F.N. clause applied in India's income tax treaties with the Netherlands, France, and Switzerland.

CASES AND ISSUES BEFORE THE SUPREME COURT

The balance of the article includes the following:

- A brief summary of the background of the cases
- The issues presented to the Supreme Court of India
- The legal arguments of the taxpayers and the tax authorities
- The judgment of the Supreme Court
- The likely effect on other taxpayers if the case is not reconsidered

[1] TS-616-SC-2023.

Concentrix Services Netherlands BV

The taxpayer was a tax resident of the Netherlands and a shareholder of several Indian companies that distributed dividends in years after the abolishment of the D.D.T. The tax rate on dividend income under the India-Netherlands Income Tax Treaty was 10%. However, the taxpayer made an application to the Indian tax authorities seeking to invoke the M.F.N. clause under the India-Netherlands Income Tax Treaty, which was signed in 1989. The taxpayer contended that the lower tax rate of 5% for dividend income provided in India's income tax treaties with Slovenia (signed in 2003), Lithuania (signed in 2011), and Columbia (signed in 2011) was imported into the India-Netherlands Income Tax Treaty under the M.F.N. clause. Slovenia, Lithuania, and Colombia were not O.E.C.D. members when their income tax treaties with India were negotiated, but each was an O.E.C.D. member on the date the application for a 5% withholding was submitted to the Indian tax authorities.

"In essence, it held that the point in time when the status of a treaty partner country as an O.E.C.D. member is not the time of signing the income tax treaty, but rather is the time of the distribution."

The tax authorities denied the application of the 5% tax rate on the ground that Slovenia, Lithuania, and Colombia were not O.E.C.D. members when their income tax treaties with India were signed. Slovenia became an O.E.C.D. member in August 2010, Lithuania became an O.E.C.D. member in July 2018, and Colombia became an O.E.C.D. member in April 2020. Consequently, Concentrix could not invoke the M.F.N. provision in the India-Netherlands Income Tax Treaty. The predicate condition for obtaining the requested M.F.N. benefit was not met; none was a member of the O.E.C.D. when the India-Netherlands Income Tax Treaty was signed.

The Delhi High Court, however, held that the benefit of the lower tax rate of 5% for dividend income under each of these tax treaties was available to Concentrix, a tax resident of the Netherlands. In essence, it held that the point in time when the status of a treaty partner country as an O.E.C.D. member is important is not the time of signing the income tax treaty, but rather is the time of the distribution. The Netherlands adopted that view in an earlier pronouncement, stating that the rate of withholding tax on intercompany dividends paid by a Dutch resident company to a company resident in India would be the lower tax rate of 5% that applies under the India-Slovenia Income Tax Treaty. According to the Delhi High Court, India cannot take a contrary stand in light of the decree and the principles of interpretation of tax treaties.

Nestle SA

Under the India-Switzerland Income Tax Treaty, the rate of withholding tax on intercompany dividends is 10%. Following its earlier decision in the *Concentrix* case, the Delhi High Court gave similar access to a lower tax rate of 5% for dividends paid to Nestle SA under the M.F.N. clause of the India-Switzerland Income Tax Treaty as Nestle was a resident of Switzerland.

Again, the Delhi High Court placed reliance on the position taken by India's treaty partner country. Swiss authorities announced that they would allow a lower withholding tax rate of 5% on dividends paid to Indian residents based on the M.F.N. clause and India's income tax treaties with Lithuania and Colombia, both of which became O.E.C.D. members after the India-Switzerland Income Tax Treaty was signed. Comparable treatment by India was expected by the Swiss tax authorities.

Steria (India) Ltd.

In the *Steria (India)* case, the taxpayer referred to Clause 7 of the Protocol in the India-France Income Tax Treaty which contains an M.F.N. clause applicable to royalties, fees for technical services, and payments for the use of equipment. Steria contended that the narrower and more restrictive definition of fees for technical services under the India-U.K. Income Tax Treaty should be applied under the India-France Income Tax Treaty by reason of the M.F.N. clause. There would not be any question of withholding tax on the payment. However, the Authority of Advanced Rulings ("A.A.R.") held that unless there is a specific notification under Section 90 of the Act, the narrower restrictive clause under the India-UK Income Tax Treaty cannot be applied under the India-France Income Tax Treaty.

The taxpayer petitioned the Delhi High Court for relief. The Delhi High Court determined that a protocol is an integral component of the income tax treaty and does not require separate notification for the invocation of the M.F.N. clause.

ARGUMENTS OF THE TAX AUTHORITIES

The tax authorities first argued that Article 253 of the Indian Constitution grants the Parliament the exclusive power to legislate on any treaty or convention entered into by India. Without Parliamentary legislation, treaties are unenforceable. India follows a dualist approach, under which international treaties require legislation to be put into effect. Reliance was placed on the Supreme Court judgments in the cases of *Gramaphone Co. of India Ltd v. Birendra Bahadur Pandey & Ors*.[2] and *Union of India (UOI) & Ors. v. Azadi Bachao Andolan & Ors*[3] to support the conclusion that without enabling legislation, neither a convention nor acts flowing from a convention are operative in India.

Turning specifically to the M.F.N. in various treaties, the tax authorities argued that similar or identical treatment cannot be extended under the M.F.N. clause of the tax treaties with the Netherlands, Switzerland, and France merely because Slovenia, Lithuania, and Colombia gained membership of O.E.C.D. several years after signing beneficial tax treaties with India. Specific notification by Indian tax authorities is required before a protocol can modify an existing income tax treaty. The word "is" as used in the M.F.N. clause – *"is a member of the O.E.C.D."* – can have present, past, or future meaning, depending on the context in which it is used. Slovenia, Lithuania, and Colombia needed to be members of the O.E.C.D. at the time of entering into the respective tax treaties with India, for the Netherlands, France, and Switzerland to claim parity of treatment.

ARGUMENTS OF THE TAXPAYERS

The taxpayers argued that the tax treaties, including protocols that contain M.F.N. clauses, are already notified under Section 90(1) of the Act. Hence, no further notification is required to make M.F.N. clauses active, unless further action or bilateral negotiation is specifically called for. An example of further action that may be needed exists in a 2001 Protocol to the India-Switzerland Income Tax Treaty. It

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[2] 1984 [2] SCR 664.

[3] 2003 (Supp4) SCR 222.

specifically provides for initiation of bilateral negotiation to ensure that benefits extended to states that later became O.E.C.D. members were given to Switzerland. A later protocol in 2010 partially eliminated the need to proceed through negotiation for a lower rate of tax. The need to negotiate continued for reducing the scope of taxable income. The taxpayers argued that the phrase *"shall also apply"* as used in the M.F.N. in the 2010 protocol made the application of the M.F.N. clause automatic, without any requirement to undertake bilateral negotiations or issue any notification for a lower rate of tax.

When the word "is" appears in the M.F.N. – *"is a member of the O.E.C.D."* – the word signifies the time when the provisions of the income tax treaty are to be applied (dynamic interpretation). It does not mean that O.E.C.D. membership must exist at the time when the income tax treaty is signed.

Reliance was also placed on the Supreme Court judgment in the case of *Union of India v. Agricas LLP*,[4] which held that any state cannot breach a treaty to which it is party, referring to any domestic law, which includes legislative, executive, or judicial decision.

SUPREME COURT'S JUDGMENT

The Supreme Court, relying on various judgments and interpretations of Article 253 of the Indian Constitution and Section 90 of the Act, concluded that, when India signs a treaty or protocol, it is not enforceable until Parliament enacts legislation enforcing the agreement. It is up to Parliament to decide whether the treaty should be binding or ignored. In such latter case, the Union will be in default of its obligations. To approve a treaty or a protocol, a notification is required under section 90(1) of the Act. Without such approval, a court, authority, or tribunal has no power to give effect to an income tax treaty or any protocol changing its terms or conditions.

Consequently, an M.F.N. clause does not automatically allow integration of a tax benefit granted to another country. As a result, the power of an M.F.N. clause to amend an earlier treaty requires separate notification under Section 90 of the Act.

Moreover, for a party to claim the benefit of a "same treatment" clause based on an income tax treaty between India and another O.E.C.D. member country, the relevant date for determining when countries are O.E.C.D. member countries is the date when India entered the treaty. In other words, the list of O.E.C.D. member countries is frozen on that date. Reference to tax rates in Indian income tax treaties with Slovenia), Lithuania, and Colombia is simply irrelevant.

COMMENTS

At the outset, it is important to note that, at the date of publication, newspaper reports suggest that a review petition has been filed with the Supreme Court stating that the judgment requires reconsideration for various reasons. Since the outcome of the petition is pending, we have not commented on the possibility of the Supreme Court judgment being overturned upon rehearing or stayed or modified. Any such subsequent development would be covered by way of a follow-up article.

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[4] [2020] 14 SCR 372.

For now, the judgment of the Supreme Court is the law of the land and provides certainty on a topic of critical importance to non-resident taxpayers in India who seek to invoke the M.F.N. clause. The M.F.N. clause is not only applied to lower the tax rate but also to reduce the scope of taxable income for certain items, such as fees for technical services, as defined broadly to include certain equipment, and royalties.

The typical position adopted by non-resident taxpayers in the past has been that the M.F.N. clause applies automatically. Given the Supreme Court's judgment, non-resident taxpayers may find that they are subject to reassessment for transactions in prior tax periods, ranging up to 10 years.

While the primary liability to pay tax is on the non-resident recipient of income, Indian authorities tend to initiate proceedings against Indian companies having withholding tax obligations. In addition to additional tax, taxpayer/withholding agents may find that they are liable for interest and penalties. While one may argue that penalties should not be levied because reasonable cause existed in the form of the M.F.N. clauses in treaties, the additional tax and interest may still be substantial.

It is evident that the outcome of the review petition is of significant importance. One of the key principles emanating from the Supreme Court judgment is that even though treaties bind the Union, Parliament's refusal to perform or give effect to such treaties can leave the Union in default. Whether this leaves the Union exposed to an international dispute, is a matter of further analysis. Even if no international dispute arises, the tax authorities of the impacted countries – notably the Netherlands and Switzerland which anticipated reciprocal tax reductions – may consider initiating dialogue with the Indian authorities to notify the M.F.N. benefit going forward, or perhaps retroactively.

For now, it appears that impacted non-resident investors will need to brace for higher taxes in India. Affected companies may find it prudent to examine exposure to additional tax, interest, and penalties and to formulate a strategy for dealing with Indian tax examiners. This may include examining the possibility of claiming additional foreign tax credits in the recipient's country of residence. There could be cases where the country of residence does not agree with the interpretation of the Indian tax authorities – again, the Netherlands, Switzerland, and France come to mind, plus other countries that have issued notices that the M.F.N. in a relevant treaty is applicable. In that case, taxpayers may wish to invoke the mutual agreement procedure ("M.A.P.") article under an applicable tax treaty. Whichever path is taken, a prolonged battle should be anticipated.

India has not agreed to the mandatory binding arbitration article under the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, which when applicable, applies when treaty partners are unable to resolve issues through discussions under a relevant M.A.P.

CONCLUSION

Given the number of cases that will be impacted by the decision of the Supreme Court of India, there is likely to be a surge in assessment / reassessment, and resulting MAP cases. One can only hope that the Indian authorities will issue a clarification that provides reasonable and much-needed certainty to taxpayers.

NEWS FROM ITALY – RECENT UPDATES TO INBOUND WORKERS REGIME AND REGISTER OF BENEFICIAL OWNERS

Authors
Andrea Tavecchio
Alessandro Carovigno

Tags
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Italian Trust
Italy
U.B.O. Register

Andrea Tavecchio is the Founder and Senior Partner of Tavecchio & Associati, Tax Advisers, Milan, Italy. His practice focuses on the field of wealth planning. He regularly assists private clients in estate, tax, and succession planning, advising on cross-border issues. He is an advisor on tax and governance matters for several Italian and international Family Offices and Trustees. He is a chartered accountant and member of S.T.E.P.

Alessandro Carovigno is a chartered accountant at Tavecchio & Associati, Tax Advisers, Milan, Italy. His practice mainly focuses on personal and estate planning, taxation of trusts and high net worth individuals. Alessandro supports both domestic and international clients in wealth planning and relocation matters.

INTRODUCTION

Over the last decade, Italy introduced tax reliefs aimed at attracting inbound investment and to spur an increase in the number of individuals coming to Italy to work or simply to live in Italy.

Flat Tax Regime

The most well-known tax relief is the Flat Tax Regime, which imposes a lump-sum tax of €100,000 per year on all foreign source income of a participating individual. The relief is available to individuals who establish residence in Italy after having been resident abroad for at least nine out of the previous ten tax years. In general, the nationality of the individual is irrelevant. Once an individual qualifies for the relief, the benefit of lump sum taxation can be extended to family members. Each family member that applies pays a lump-sum tax of only €25,000.

Participants in the Flat Tax Regime benefit from several additional provisions of Italian law:

- They do not report foreign assets other than qualified shareholdings in foreign companies, which must be reported only in the first five years.
- They are exempt from the payment of wealth taxes on real estate properties and financial assets held abroad.[1]
- They are exempt from inheritance and gift tax on foreign situs assets.

Other Regimes

A lesser known tax relief is the Inbound Workers Regime. It allows for a 70% tax exemption on income derived from working activity performed in Italy. In some instances, the exemption is 90%.

Finally, Italian law provides a third form of tax relief for arriving retirees. Under the Pensioners Regime, a foreign retiree who establishes residence in Italy's southern region pays a substitute tax of 7% on all non-Italian source pension income. To qualify for the regime, the following conditions must be met:

- The individual must receive a "pension income" paid by a non-Italian entity.
- The individual must not have been a resident of Italy for the five years prior the period in which the benefit is first claimed.

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[1] I.V.I.E. is the wealth tax applicable to real estate. I.V.A.F.E. is the wealth tax applicable to financial assets.

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- During that five-year period, the individual must have resided in one or more countries having in effect an administrative cooperation agreement with Italy.
- Residence must be established in a municipality in a southern region that has a population of up to 20,000 inhabitants. Such regions include Sicily, Calabria, Sardinia, Campania, Molise, Puglia, Abruzzo, and Basilicata.

2023 ITALIAN TAX REFORM

In its session of October 16, 2023, the Italian Government approved a draft legislative decree on international taxation. The decree is now under discussion by the relevant parliamentary committees. In particular, the draft legislative decree addresses the tax regime for inbound workers. The proposed modifications do not impact the Flat Tax Regime or the Pensioners Regime.

Inbound Workers Regime – Current Provisions

As mentioned above, the Inbound Workers Regime currently provides a tax exemption of 70% of employment income, including salary and benefits, and business and self-employment income derived from personal services performed in Italy. The tax exemption is 90% when the taxpayer relocates to one of the Southern Regions previously mentioned. As a consequence, the taxable 30% or 10% share of Italian employment income is liable to ordinary personal income tax, with brackets ranging up to 43%, plus local surcharges of approximately 2%. In relation to income from self-employment and business income, the Inbound Workers Regime is subject to State Aid *de minimis* rules, which cap the tax relief €200,000 over a three-year period.

Tax relief granted by the Inbound Worker Regime is available under existing law where the following requirements are met:

- The individual transfers tax residence to Italy.[2]
- The individual has not been resident in Italy during the two tax periods preceding a transfer of tax residence to Italy.
- The worker commits to maintain Italian tax residence for a minimum period of two years.
- The taxpayer performs the working activity mainly in Italy.

The tax benefit is available for up to five consecutive years. If certain additional requirements are met and tax residence in Italy is maintained for an additional five-year period, scaled back benefits are allowed for the additional five tax years. The additional scaled back benefits are available if, and only if, the individual remains tax resident in Italy for the full additional period of five years.

If the individual meets the additional residence requirement and the other conditions regarding dependent children or full ownership of a residence, the following percentages of income will be subject to personal income tax[3] in years six through ten:

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[2] Article 2, par. 2 of the Italian Income Tax Code ("I.T.C.").

[3] I.R.P.E.F.

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- 50%, if the worker has a minor or dependent child, including if in pre-adoptive care
- 50%, if the worker acquires full ownership of at least one residential real estate unit in Italy following their transfer to Italy or in the twelve-month period prior to the transfer to Italy
- 10%, if the worker has at least three minor or dependent children, including children in pre-adoptive care

Inbound Workers Regime – Proposed Amendments

The proposal provides for a 50% reduction in taxable income on an amount of income not exceeding €600,000 if the following conditions are met:

- The worker establishes a tax residence in Italy, as under existing law.
- The benefit is limited to employment income, income that is assimilated to employment, and self-employment income. Business income other than self-employment income is excluded.[4]
- The individual has not been resident in Italy during the three tax periods preceding a transfer of tax residence to Italy.
- The individual commits to remain tax resident in Italy for at least five years. If the five-year residence requirement is not met, the tax authorities will take steps to recover the tax benefit in full. Penalties and late payment interest will also be applied.
- More than 50% of the workdays each year must take place in Italy.
- The reduction in tax does not apply to days worked outside Italy.
- The employee cannot work in Italy for the same company that employed the individual prior to the move to Italy or for a company in Italy that is a member of the same group of companies as the prior employer. The workers must meet the requirements of high qualification or specialization.
- In case of self-employment income, the state aids *de minimis* rules remain applicable. The relief is capped at €200,000 over a three-year period after arrival in Italy.
- The duration of the tax benefit is limited to five years, with no extensions.

The new regime applies to individuals taking Italian tax residence beginning with tax year 2024. However, a grandfathering rule likely will apply the more favorable existing relief for individuals who became Italian residents by enrolling in the Register of the Resident Population in Italy (*Anagrafe della Popolazione Residente*) not later than December 31, 2023.

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[4] Pursuant to Italian law, self-employment and business income are two different kinds of income. Each case usually requires a specific analysis. Generally speaking, self-employment income is made from arts and professions, while business income is made from commercial activities.

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ITALIAN REGISTER OF BENEFICIAL OWNERS: TRUSTS

> ***"The Register of Beneficial Owners of enterprises with legal personality, private legal entities, trusts, and similar legal arrangements has become operational at the Italian Chamber of Commerce."***

The Register of Beneficial Owners (the "Register") of enterprises with legal personality, private legal entities, trusts, and similar legal arrangements has become operational at the Italian Chamber of Commerce.

The Register is held by the local Chamber of Commerce and consists of two sections. The ordinary section holds the data of the Ultimate Beneficial Owners of companies with legal personality and private legal entities. Companies with legal personality include limited liability companies, joint-stock companies, limited partnerships limited by shares, and cooperative companies. Private legal entities include foundations and recognized associations. The special section contains the data of the Ultimate Beneficial Owners ("U.B.O.'s") of trusts and similar legal arrangements.

U.B.O.'s of Trusts and Similar Entities

Pursuant to Italian Anti-Money Laundering ("A.M.L.") Rules, the U.B.O. is the individual or individuals in whose interest a professional service is rendered, or a business relationship is held. In the specific case of a trust, the U.B.O.'s are the Settlor during his lifetime; the trustee; the protector, if any; the beneficiaries or the living individuals who are included among the beneficiaries; other individuals holding the power to control the trust as well as any other person who ultimately, directly or indirectly, controls the assets transferred to the trust.

If the settlor, the trustee, or other persons who have the control over the Trust are companies or similar entities, the listed U.B.O.'s of the trust are the same persons who are U.B.O.'s of such entities.

Persons Obliged to Communicate the Relevant Data

In the case of a trust or an equivalent arrangement, the trustee is the person responsible for providing information on all U.B.O.'s to the Register of Enterprises at the Italian Chamber of Commerce. A self-declaration is all that is required when the trust is set up or is resident in Italy and the trust carries out activities that have legal effect in Italy or leads to consequences for Italian tax purposes, such as when the trust derives income from Italy, owns assets in Italy, or is liable to Italian taxation for any reason.

Pursuant to current Italian Tax Law and clarifications provided by the Italian Tax Authority, a trust is deemed to be a tax resident in Italy if any of the following conditions is met for the greater part of the year, meaning 183 days:

- The trustee is an Italian resident individual or company.
- The trustee's employees, offices, or operating structure is located in Italy.
- The main purpose of the trust is carried out in Italy.

It is worth noting that the draft legislative decree on international taxation revises the criteria used to determine residence for corporate entities and trusts. In particular, two of the current criteria – seat of administration and main purpose – will be repealed and replaced with the following criteria:

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- The place of effective management, which is defined as the place of the continuous and coordinated taking of strategic decisions concerning the company or entity as a whole.

- The place of routine management, which means the place of continuous and coordinated performance of day-to-day management acts concerning the company or entity as a whole.

These new criteria could also affect the tax residence of trusts and thus the reporting obligations to the Register.

Relevant Information to be Filed

The following information must be filed:

- The identity of the U.B.O., including (i) name, (ii) surname, (iii) place and date of birth, (iv) places of residence and domicile, if different from the registered residence, (v) details of the identification document, and (vi) the Italian tax identification number, if any.

- Information regarding the trust, including its (i) the tax identification number, (ii) name, (iii) the date, place, and details of the deed of trust.

Access to the U.B.O. Register

Access to the data held by the special section of the U.B.O. Register is restricted to the following:

- Public entities (including tax and judicial authorities)

- Entities and individuals obliged to carry out A.M.L. procedures, due to their particular activity; examples include banks, public notaries, chartered accountants, lawyers, and other professionals who are required by law to identify the beneficial owner before starting their professional or commercial relationship

- Other persons demonstrating a legitimate interest at protecting or defending their legal position, in case a discrepancy between beneficial ownership and legal title arises

Access to the information contained in the U.B.O. Register may be denied if the beneficial owner is exposed to a disproportionate risk of fraud, harm, kidnapping, blackmail, extortion, harassment, violence, or intimidation, or if he or she is a minor or incapacitated person (so-called "counter-interested parties"). In this case, relevant information in order to determine such exceptional circumstances must be communicated to the U.B.O. Register.

Access to the U.B.O. Register used to be open to the public pursuant to E.U. A.M.L. rules. However, by issuing its ruling of November 22, 2022, the Court of Justice of the European Union limited the access to data on beneficial ownership of companies and private legal entities to those individuals who have a relevant and actual legitimate interest.

Access by parties that carry out A.M.L. procedures must apply for accreditation to the relevant Chamber of Commerce office in order to have access to the data on beneficial ownership. Other entities and individuals wishing to access information

must submit a request explaining the reason justifying the request for access to the information. The final decision is made by the relevant Chamber of Commerce office.

Deadlines

The deadline for the filing of the relevant data to the U.B.O. Register is December 11, 2023. The filing must be made by the (i) directors of companies; (ii) the founder, if alive, or legal representative for private legal entities; and (iii) the trustees for trusts and similar legal arrangements.

For companies, private legal entities, trusts, and similar legal arrangements set up after October 9, 2023, the first filing is made within 30 days of formation.

Any changes in data and information regarding the beneficial owner must be filed within 30 days following the relevant deed.

Penalties

A failure to file data of the U.B.O. triggers the imposition of administrative penalties ranging from €103 to €1,032. In addition, a person who intentionally provides false statements is subject to criminal punishment.

ENTERING A NEW DIMENSION – O.E.C.D. TRANSFER PRICING GUIDANCE AS HARD TAX LAW

Authors
Michael Peggs
Michael Bennett

Tags
B.E.F.I.T. Directive
Hard Law
O.E.C.D. Guidelines
Soft Law
Taisei
Transfer Pricing

INTRODUCTION

Multilateral transfer pricing guidance from the O.E.C.D. was first released in 1979. A version of *O.E.C.D. Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*[1] (the "O.E.C.D. T.P. Guidelines") has been in print since 1995, long enough that U.S. international tax practitioners are by now accustomed to hearing foreign colleagues talk sometimes interchangeably about country transfer pricing legislation and the O.E.C.D. T.P. Guidelines.

U.S. transfer pricing regulations, the commensurate with income standard, and the economic substance doctrine are codified under Code §§482 and 7701(o) and Treas. Reg. §§1.482-1 through 1.482--9. The only external references that guide the I.R.S. and taxpayers are applicable Revenue Procedures published by the I.R.S. (such as Rev. Proc. 2007-13 concerning certain specified covered services referenced in the services regulations) and case law.

Foreign transfer pricing law, by contrast, frequently includes a provision that references the O.E.C.D. T.P. Guidelines as the guidance that must be used to interpret other provisions of relevant law. O.E.C.D. member tax administrations and other national tax administrations publish their own interpretive guides to the O.E.C.D. T.P. Guidelines and add to a body of administrative guidance over time with subject-specific bulletins or memoranda. Often, material is published by a national tax administration following a court decision or a trend in controversy. Like other wide variations in standard practices some might think should be more alike, a tax administration's deviation from the median interpretation of the O.E.C.D. T.P. Guidelines can change over time and can also differ between treaty partners. Double tax controversy leads companies and tax administrations into Competent Authority proceedings where the agreed common interpretation of the arm's length principle is none other than the same O.E.C.D. T.P. Guidelines.

The European Commission has recently proposed a Council Directive on transfer pricing released as part of the *Business in Europe: Framework for Income Taxation* ("B.E.F.I.T."). The Directive proposes to codify the arm's length principle and elements of its interpretation from the O.E.C.D. T.P. Guidelines, clarify the role of the O.E.C.D. T.P. Guidelines in Member State law, and homogenize the interpretation of the same guidelines among the tax administrations of E.U. Member States. In addition to the Directive itself, we are interested in how a new approach between E.U. members will influence each individual E.U. Member State's tax administration approach to interpreting the O.E.C.D. T.P. Guidelines when examining transactions of E.U. resident companies with group companies resident in treaty partner countries

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[1] O.E.C.D. (2022), O.E.C.D. Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, O.E.C.D. Publishing, Paris.

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outside the E.U. We are further interested in how these same tax administrations will approach M.A.P. and A.P.A. matters through their respective Competent Authorities. Negotiating history is hard to ignore, and our guess is that the result will be non-uniform.

In addition, two major U.S. trading partners, the U.K. and Canada, are currently undergoing revisions to their transfer pricing legislation that contemplate references to the O.E.C.D. T.P. Guidelines. Both developments are taking place as G20 countries and others move toward variously ceding and gaining taxation rights through the labyrinthine mechanical workings of Pillars I and II as part of another O.E.C.D. digital economy project. For companies within the scope of the Pillar I rules, formulary apportionment (this time the equivalent of a complex differential equation in contrast to the simple approaches used to apportion income among U.S. states, typically involving one, two, or three factors) is intended in part to provide relief from the need to navigate through the fog and potential longer-term tax uncertainty of O.E.C.D. T.P. Guidelines interpretations.

In what follows, we begin the task of understanding the possible future role or roles of the O.E.C.D. T.P. Guidelines. The O.E.C.D. T.P. Guidelines have been classified by others as "soft law."[2] The document itself is after all written variously as a discussion of possible best practices, recommended approaches, and more definite guidance representing an incomplete consensus of O.E.C.D. Member State tax authorities, and not in the if/then form of rules governing transfer pricing positions for tax purposes. We examine recent developments to determine whether O.E.C.D. "soft law" may be hardening over time and begin by looking for clues outside of the field of transfer pricing.

U.S. CASE LAW – *TAISEI FIRE & MARINE INSURANCE CO.*

O.E.C.D. "soft law" frequently serves as a tool for interpreting multi-jurisdictional agreements, including tax treaties. Courts often rely on the O.E.C.D. Model Treaty and its commentaries to interpret provisions of bilateral income tax treaties between two countries. A notable example is found in the case of *Taisei Fire and Marine Insurance v. Commr.,*[3] where the tax court consulted the 1977 Commentary to the O.E.C.D. Model Treaty to interpret the permanent establishment article in the U.S.-Japan Income Tax Treaty.

In *Taisei Fire*, several Japanese insurance companies individually authorized a U.S. company to serve as a reinsurance underwriting manager empowered to enter into contracts on their behalf. The central issue was whether each of the Japanese insurance companies had a U.S. permanent establishment through the actions of the U.S. agent. The crucial determinant was whether the U.S. agent maintained an "independent status," as the absence of such independence would lead to the Japanese companies being deemed to have a U.S. permanent establishment.

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[2] Alberto Vega, *International Governance through Soft Law: The Case of the OECD Transfer Pricing Guidelines*, Max Planck Institute for Tax Law and Public Finance Working Paper 2012 – 05, July 2012

[3] *Taisei Fire & Marine Ins. Co. v. Commr.*, 104 T.C. 535 (1995).

The U.S.-Japan Income Tax Treaty did not provide a definition for an "agent of an independent status." However, the court recognized that the relevant provisions were not only based upon, but also duplicative of those found in the O.E.C.D. Model Treaty.[4] Consequently, the court turned to the commentary accompanying the O.E.C.D. Model Treaty, which articulated that the test for independent status involves both legal and economic independence. The court ultimately held that given the lack of guidance in the U.S.-Japan Income Tax Treaty, the Japanese insurance companies did not have a permanent establishment based on the approach suggested by the O.E.C.D. Model Treaty.

The role of O.E.C.D. guidance in U.S. treaty interpretation has increased since the 1995 Tax Court decision. The U.S. explicitly embraced the O.E.C.D. approach in its 2006 and 2016 Model Treaties. According to the O.E.C.D. approach, a permanent establishment is treated as a functionally distinct entity for the purpose of attributing business profits. Furthermore, the O.E.C.D. approach stipulates that business profits should be determined based on the arm's length standard, applying transfer pricing principles to branch operations.

Taisei Fire serves as an illustration that a U.S. court can indeed draw upon O.E.C.D. guidance to aid in resolving a contentious legal issue involving a treaty provision that is based on a provision in the O.E.C.D. Model Treaty. Nevertheless, the extent to which a court will and should rely on such guidance remains a subject of uncertainty and debate.

OTHER O.E.C.D. GUIDANCE – O.E.C.D. GUIDELINES FOR MULTINATIONAL COMPANIES

Before the introduction the O.E.C.D. T.P. Guidelines, the O.E.C.D. introduced the Guidelines for Multinational Enterprises ("M.N.E. Guidelines") in 1976, a thorough collection of government-recommended measures for M.N.E.'s to willingly embrace.[5] The purpose of the M.N.E. Guidelines is to mitigate and address potential impacts stemming from activities in foreign locations, and promoting positive contributions to economic, social, and environmental advancement. These guidelines encompass various aspects, including human rights, environmental practices, labor standards, anti-bribery measures, corporate governance, disclosure practices, supply chain management, and taxation. Internationally, these guidelines enjoy widespread support and stand as the sole multilaterally agreed-upon and comprehensive set of principles for responsible business conduct and are actively endorsed by governments.

Though widely accepted by countries throughout the world, observance of the M.N.E. Guidelines by enterprises is voluntary and not legally enforceable. The M.N.E. Guidelines do not supersede domestic law and are not designed to place enterprises in situations of conflicting requirements. Nevertheless, some matters covered by the M.N.E. Guidelines may be regulated by national law or international commitments.

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4 See discussion by the court in the text of the case at note 5.

5 O.E.C.D. (2023), OECD Guidelines for Multinational Enterprises on Responsible Business Conduct, OECD Publishing, Paris.

Despite the voluntary nature of the M.N.E. Guidelines, signatory governments are required to establish a National Contact Point ("N.C.P."). Among their various responsibilities, N.C.P.'s play a crucial role in handling disputes, referred to as "specific instances." This process serves as a non-judicial grievance mechanism, activated when a party raises allegations against the operations of a multinational enterprise.

The parameters defining the legal significance of the M.N.E. Guidelines are explicitly outlined and commonly understood. This stands in contrast to the O.E.C.D. T.P. Guidelines, where the line between general guidance and legal enforceability is blurred.

E.U. B.E.F.I.T. DIRECTIVE AND THE O.E.C.D. T.P. GUIDELINES

Part of the larger B.E.F.I.T. legislative package that aims to set out rules for large companies in the E.U., a recent Council Directive on Transfer Pricing[6] ("the Directive") aims to use the O.E.C.D. T.P. Guidelines to harmonize the interpretation of the arm's length principle between E.U. Member States. Member States for the most part have legislated O.E.C.D. T.P. Guidelines the task of interpretation of the arm's length principle. The B.E.F.I.T. transfer pricing proposal goes one step further to elevate the O.E.C.D. T.P. Guidelines into E.U. law by making them more than the arm's length principle interpretive standard.

The Directive requires that Member States adopt a common definition of associated enterprises as an initial condition to delineating a controlled transaction and proposes a new fast-track and joint audit approach to facilitate corresponding transfer pricing adjustments between companies resident in E.U. Member States to minimize the risk of double taxation. One of the several positive intended effects of the Directive is to reduce or eliminate the need for transfer pricing rulings from E.U. Member State tax authorities that have historically caused significant State Aid and other controversy, especially when granted as a unilateral ruling. The remainder of the Directive concerns the identification and pricing of a controlled transaction, with the well-known "delineation of the actual transaction" O.E.C.D. T.P. Guidelines language which is taken verbatim from paragraph 1.33 without including the plural "transactions."

"The B.E.F.I.T. transfer pricing proposal goes one step further to elevate the O.E.C.D. T.P. Guidelines into E.U. law. . ."

Further use of terms from the O.E.C.D. T.P. Guidelines appears throughout the Directive, which is largely a simplified paraphrasing of the O.E.C.D. T.P. Guidelines. The 451 pages of the O.E.C.D. T.P. Guidelines are not, however, able to be collapsed into 17 pages of draft Directive like 17 clowns into a Citroën *Deux Chevaux*. The distillation effort in drafting results in certain non-subtle departures from the O.E.C.D. T.P. Guidelines, thereby creating the potential for future controversy among E.U. Member States and between E.U. Member States and non-E.U. treaty partners where the approach of the Directive becomes the rule followed by a Member State's tax administration.

The term "best evidence," for example, is used in the Directive preamble to describe the utility of an intercompany contract *for the purpose of identifying the transaction or transactions actually undertaken* between two controlled corporations. Less

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6 *Proposal for a Council Directive on Transfer Pricing*, SWD(2023) 308-309, (European Commission, September 9, 2023)

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weight is given to a written intercompany contract by the O.E.C.D. T.P. Guidelines in accurately delineating the controlled transaction at issue. Paragraphs 1.36 and 1.43 of the O.E.C.D. T.P. Guidelines indicate that a written contract is important but is not the only item of information used to identify and understand the actual controlled transaction. In the O.E.C.D. T.P. Guidelines, the "best evidence" term describes the utility of a written contract *in determining the intention of the parties* in relation to the assumption of risk.

The Directive's explanation of the sufficient conditions for determining comparability are the O.E.C.D. T.P. Guidelines conditions relevant to transactional methods only. More detailed interpretive guidance on the comparability standard relevant to the application of the transactional net margin method, or T.N.M.M., the C.P.M.'s O.E.C.D. cousin, is absent from the draft Directive and must be taken from Chapter II of the O.E.C.D. T.P. Guidelines. Absent an amendment, the O.E.C.D. T.P. Guidelines will play their historical "soft law" interpretive role in this respect.

Finally, the interquartile range that is explained as an option for summarizing a group of uncontrolled pricing or profitability statistics under the O.E.C.D. T.P. Guidelines – which is disliked by certain O.E.C.D. Member State tax administrations – defines the arm's length range under the draft Directive. This may portend a possible reduction in friction in U.S. double tax cases. Those O.E.C.D. Member State tax authorities that are not proponents of the interquartile range may experience difficult double tax case negotiations. The Canada Revenue Agency is an example.

In sum, "soft law" in the form of the O.E.C.D. T.P. Guidelines appears to harden into hard law under the language of the Directive despite paragraph 15 of the Directive's preamble that refers to the O.E.C.D. Transfer Pricing Guidelines in an interpretive capacity, consistent with the legislation of many E.U. and O.E.C.D. Member States. The Directive defines the O.E.C.D. T.P. Guidelines to mean the 2022 publication date version and incorporates subsequent amendments by statute.

LEGISLATIVE AND ADMINISTRATIVE USE OF THE O.E.C.D. T.P. GUIDELINES

Many non-E.U. Member State tax administrations have a long-standing connection to the O.E.C.D. T.P. Guidelines through their involvement with the O.E.C.D.'s tax policy and administration development work. The outcome has been direct or indirect legislative reference to the O.E.C.D. T.P. Guidelines and published administrative guidance that references or follows the O.E.C.D. T.P. Guidelines.

The U.S. does not reference the O.E.C.D. T.P. Guidelines in its transfer pricing regulations, or publish a companion interpretive document as is done by tax administrations both within and outside the E.U. As an O.E.C.D. Member State, the U.S. works with other O.E.C.D. Member States through its treaty network to resolve double tax cases. The acknowledgement of the O.E.C.D. T.P. Guidelines as an element of the *lingua franca* in these multilateral settings appears only in I.R.S. Rev. Proc. 2015-41 and select training material of the I.R.S.

In this sense, the U.S. follows an approach similar to Korea, China, Japan, and Israel (among other non-E.U. O.E.C.D. Member States) and does not specifically cite the O.E.C.D. T.P. Guidelines in country legislation as a means of interpreting the relevant provision of law. The legislation of the foregoing countries resembles the

Directive to the extent that a general claim is made concerning consistency with, or incorporation of, the basic aspects of the O.E.C.D. T.P. Guidelines.

Country decrees and administrative guidance issued as supplements to enacted legislation may incorporate or refer to the O.E.C.D. T.P. Guidelines when a tax administration explains its approach to certain aspects of its interpretation of the arm's length principle. Some tax administrations continue to roughly paraphrase the O.E.C.D. T.P. Guidelines without any citation in guidance publications. China's *Public Notice of the State Administration of Taxation [2017] No.6* is a good example. It restricts the role of the O.E.C.D. T.P. Guidelines strictly to "soft law."

"C.R.A. proposes to codify the term 'economically relevant characteristics' to mean something different than the definition in the O.E.C.D. T.P. Guidelines . . ."

U.K. AND CANADIAN CONSULTATIONS

In mid-2023, both the U.K. and Canada began consultations on amendments to specific aspects of their respective transfer pricing legislation. U.K. legislation incorporated the O.E.C.D. T.P. Guidelines (and subsequent amendments) for the purpose of interpreting the arm's length principle in 2004, while Canada's legislation has not. Both countries have issued administrative guidance that cites the O.E.C.D. T.P. Guidelines before the respective consultations commenced, though in different ways and with different points of emphasis.

The U.K. consultation question relevant to the O.E.C.D. T.P. Guidelines was relatively narrow in scope and contemplated the replacement of the term "provision" used in U.K. transfer pricing legislation to indicate the series of conditions comprising a controlled transaction with the term "conditions" for the purpose of greater consistency with the language of Article 9(1) of the O.E.C.D. Model Tax Convention.

Article 9(1) uses the term "conditions" in the following phrase:

> * * * conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises * * *.

The phrase is a critical part of the Article 9 text that is interpreted by the O.E.C.D. T.P. Guidelines. One purpose of the U.K. consultation was to solicit input on the practical implication of the proposed change in terminology for the operation of domestic legislation. H.M.R.C.'s practical concern was the over-broad scope of the term "conditions" in comparison to the term "provision" used elsewhere in legislation.

The Canada Revenue Agency ("C.R.A.") began its legislative consultation after the Federal Court of Appeal found for the taxpayer in *The Queen v. Cameco Corporation*, 2020 FCA 112 and the Supreme Court of Canada refused leave to appeal, thwarting the C.R.A.'s attempt to recharacterize a controlled transaction based on proposed series of alternate transaction circumstances. The C.R.A. consultation asked for input on the question of the codification of the term "economically relevant characteristics" used to further describe a controlled transaction. Article 9(1) of the Model Convention, with which H.M.R.C. seeks to harmonize its legislative language, refers to the actions ("conditions made or imposed") of two related parties resulting in the establishment of a series of "conditions" that define the controlled transaction. The O.E.C.D. T.P. Guidelines make it clear that contractual terms are only one of the economically relevant characteristics or comparability factors that describe or

delineate a controlled transaction.[7] C.R.A. proposes to codify the term "economically relevant characteristics" to mean something different than the definition in the O.E.C.D. T.P. Guidelines and to define the term "conditions" broadly.

The proposed U.K. amendment retains the O.E.C.D. T.P. Guidelines as "soft law" and reduces a possible conflict between domestic law and the U.K.'s double tax treaties. The proposed Canadian amendment generally incorporates the O.E.C.D. T.P. Guidelines conditionally and proposes inexact codification of one element ("economically relevant characteristics") of the same guidelines. Whether the result is hard law on the outside and soft in the middle, or something else entirely remains to be seen in draft legislation and the litigation that will follow.

CONCLUSION

Distinct from the status of the O.E.C.D. Model Treaty and M.N.E. Guidance as non-binding guidance with well-defined parameters of legal significance, the O.E.C.D. T.P. Guidelines may be set to step out of their historical role as "soft law" and into a role as either a stronger authority on the interpretation of the arm's length principle or the source of legislative language itself. From a U.S. perspective, this signals a growing heterogeneity in transfer pricing approaches among treaty partners, and a potential hardening of treaty partner positions in double tax cases as O.E.C.D. T.P. Guidelines guidance is enacted as law in one form or another.

If we accept the proposition that the O.E.C.D. T.P. Guidelines are "soft law" and effective to the greatest extent in their current form, are the E.U. and Canada asking too much of these guidelines by proposing codification of one type or another? The positive role played by other legally non-binding O.E.C.D. guidance in fostering international cooperation and harmonized approaches suggests this may become a future concern. The current O.E.C.D.-led efforts to reform the taxation of digital commerce with the legislation of Pillar I and II by the adoption of a multilateral instrument may provide relief for large multinational groups but leave controversy for all others to resolve.

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7 O.E.C.D. TP Guidelines, para. 1.36

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DID YOU JUST MANIFEST THE OPPOSITE OF WHAT YOU WANTED - (IN)ABILITY TO USE G.I.L.T.I. LOSSES TO OFFSET GAIN

Authors
Stanley C. Ruchelman
Neha Rastogi

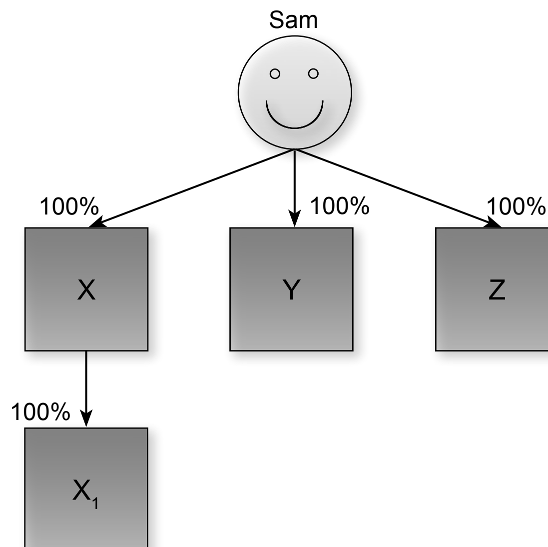
Tags
C.F.C.
Code §1248
Code §267(b)
Code §951A
Code §962
Form 5471
G.I.L.T.I.
N.O.L.
Tested Income

INTRODUCTION

This article addresses the G.I.L.T.I. rules that currently are in effect in the U.S. when a U.S. Shareholder of a C.F.C. engaged in an active business run at a loss sells its business assets at a gain. It also addresses certain reporting obligations on a U.S. Shareholder when a C.F.C. undergoes some form of tax-free merger or reorganization abroad.

BACKGROUND

Sam is a U.S. citizen who is the sole shareholder of three foreign corporations, X Co, Y Co, and Z Co, that are tax residents of country A. Sam is an indirect shareholder of X_1 Co, a tax resident of Country A, that is wholly owned by X Co.



All of the Country A corporations are C.F.C.'s. Both X Co and X_1 Co are engaged in the hospitality business, and each owns a fully operational multi-story hotel in Country A (Hotel X and Hotel X_1 respectively). Y Co and Z Co are also engaged in active trade or businesses in country A.

The annual financial and tax statements of each of the three C.F.C.'s have reported operating losses for several years. X Co and X_1 Co were merged under the corporate law of Country A in 2022, with X Co as the surviving company (the "Merger"). Post-Merger, X Co sold a portion of Hotel X, reporting a substantial gain for both U.S. and Country A purposes.

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The Merger was effected as a tax-free transaction in Country A. Further, the laws of Country A allow X Co to fully offset the gain arising from the sale with losses of Company X and Company X_1. As a result, no tax was paid in Country A in connection with the Merger and the sale.

As Sam narrated the transaction to his U.S. tax adviser as the U.S. tax filing due date approached, he was hopeful that similar tax results as in Country A can be achieved in the U.S. However, as he came to realize, he had manifested just the opposite of what he wanted. The tax adviser advised him of the following hurdles the transaction must overcome to achieve a tax-free treatment in the U.S. In principle, specific conditions must be satisfied in order for a merger involving a C.F.C. to be tax-free for a U.S. Shareholder. He also came to realize that the G.I.L.T.I. provisions of U.S. tax law that apply to U.S. Shareholders and C.F.C.'s may not provide the results that Sam anticipates.

Definitions

A foreign corporation is a C.F.C. for U.S. income tax purposes if more than 50% of the total voting rights of all classes of stock or the total value of the stock is directly or indirectly (through another corporation) owned by "U.S. Shareholders."[1] A U.S. Shareholder is a U.S. person that directly, indirectly, or constructively owns shares of the foreign corporation that represent 10% or more of the vote or value of all shares issued and outstanding.[2] A U.S. person includes a citizen or resident of the United States.

Indirect ownership includes ownership through foreign entities.[3] Constructive ownership in general includes ownership attributed to a person under Code §318(a)[4] with certain modifications.[5]

Based on the above, X Co and X_1 Co are C.F.C.'s for U.S. income tax purposes because more than 50% of the voting rights or value in each of the companies is either directly or indirectly held by Sam, a U.S. citizen. Also, Sam is a U.S. Shareholder of each C.F.C. since he owns directly or indirectly 10% or more of the voting stock or value of each company.

A STATUTORY MERGER

Merger Defined

Typically, a statutory merger of two or more corporations by operation of law is included in the term "reorganization," meaning a tax-free, nonrecognition transaction

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1 Code §957(a).

2 Code §951(b).

3 Code §958(a)(2).

4 Relationships are as follows: (i) from members of family, (ii) from partnerships, estates, trusts, and corporations, (iii) to partnerships, estates, trusts, and corporations, and (iv) under options. Certain operating rules can affect how the attribution rules are applied.

5 Code §958(b).

for U.S. tax purposes.[6] One noted treatise describes a merger in the following language:

> Under § 368(a)(1)(A), a statutory (*i.e.*, under the controlling corporate law statute) merger or consolidation is the oldest of, and the prototype for, the various reorganization forms. In a merger, one corporation absorbs the corporate enterprise of another corporation, with the result that the acquiring company steps into the shoes of the disappearing corporation as to its assets and liabilities. * * *. In these transactions, shareholders and creditors of the disappearing transferor corporations automatically become shareholders and creditors of the transferee corporations by operation of law, assets move by operation of law, and transferor corporations can disappear as legal entities, resulting in a dissolution of the acquired corporations. [Footnotes omitted.][7]

In addition to the above, the Merger must meet the following non-statutory requirements to qualify as a tax-free merger for U.S. tax purposes.

Valid Business Purpose

There must be a valid business purpose other than tax avoidance. In other words, the purpose of the reorganization must be required by business exigencies, an ordinary and necessary incident of the conduct of the enterprise, and not a device or scheme to avoid tax.

Continuity of Interest

The purpose of the continuity of interest requirement is to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations. This requirement, in general, therefore, requires that the shareholders of the target corporation receive a substantial equity interest in the acquiring corporation. In the present case, the statutory merger involves a merger of the subsidiary with the parent, and therefore, the continuity of interest condition should be deemed satisfied since the parent acquired all of the assets and liabilities of the subsidiary.

Continuity of Business Enterprise

After the transaction, the acquiror must either continue the target's historic business or use a significant portion of the target's assets in an existing business. The policy underlying this general rule is to ensure that reorganizations are limited to readjustments of continuing interests in property under modified corporate form. The fact that X Co sold a portion of the first floor of Co X_1's hotel should not fail this requirement since X Co continues to own and operate a substantial portion of the property as a hotel after the Merger.

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[6] Code §368(a)(1)(A).

[7] Bittker & Eustice: Federal Income Taxation of Corporations & Shareholders (WG&L), ¶ 12.21 Statutory Mergers and Consolidations (Type A Reorganization).

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SPECIAL REQUIREMENTS FOR FOREIGN REORGANIZATIONS

However, where a merger involves foreign corporations, the nonrecognition treatment is turned off in the event the transaction results in the loss of status of a U.S. person as a "Code §1248 Shareholder" in relation to a C.F.C. that is party to the merger.[8] A Code §1248 Shareholder is any U.S. person who directly, indirectly, or constructively owns 10% or more of the voting rights in a foreign corporation at any time during the prior five-year period, provided the foreign corporation was a C.F.C. at a time when the shareholder held 10% or more of its stock.[9] Nonrecognition treatment is turned off when the U.S. person no longer is a U.S. Shareholder and Subpart F and G.I.L.T.I. are no longer applicable, as a result.

"A U.S. Shareholder of a foreign corporation surviving as a result of a merger is required to file a notice with the I.R.S. notifying it of the merger."

As discussed above, Sam directly owned 100% of the voting rights in X Co and indirectly (through X Co) owned 100% of the voting rights in X_1 Co prior to the merger. Therefore, Sam meets the definition of a Code §1248 Shareholder with respect to both corporations as each was a C.F.C. during his holding period.

Under the present facts, Sam was a §1248 Shareholder with respect to both, X Co and X_1 Co. Pursuant to the Merger, X_1 Co disappeared, and X Co continued to survive with the earnings, assets, and liabilities of X_1 Co. X Co continues to be a C.F.C. and Sam continues to be a §1248 Shareholder in relation to X Co. Therefore, the §1248 Shareholder status of Sam does not cease to exist as a result of the Merger. As a result, the Merger should be given a tax-free treatment for U.S. tax purposes and Sam should not be subject to U.S. tax as a result of the Merger.

REPORTING REQUIREMENTS

Sam has certain reporting obligations that generally apply when a U.S. taxpayer exchanges shares as a result of a reorganization[10] and other reporting obligations that apply when C.F.C.'s are involved.[11]

Reporting Requirements Relevant to the Merger

A U.S. Shareholder of a foreign corporation surviving as a result of a merger is required to file a notice with the I.R.S. notifying it of the merger ("Code §367(b) Notice"). The §367(b) Notice must be filed even if no income is required to be recognized under Code §367(b).

The Code §367(b) Notice must be attached with Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, relevant to the surviving foreign corporation for the year in which the transaction occurs.[12] The §367(b) Notice generally must contain the following information:[13]

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8 Treas. Reg. §1.367(b)-2(b).

9 Code §§1248(a)(2), 1248(c)(2).

10 See generally Treas. Reg § 1.368-3.

11 See generally, Treas. Reg. §1.367(b)-4(c).

12 Treas. Reg. §§1.367(b)-1(c)(3)(ii)(A); 1.367(b)-1(c)(2)(i)(v).

13 Treas. Reg. §1.367(b)-1(c)(4).

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- The fact that the transfer is a §367(b) transfer
- A complete description of the transfer
- A description of any stock, securities, or other consideration transferred or received
- A statement that describes any amount(s) required under the Code §367(b) regulations to be taken into account as income or loss or as an adjustment to basis, E&P, or other tax attributes as a result of the transfer

Reporting Requirements Relevant to X Co

Sam is also required to file one last Form 5471 for 2022 in relation to X_1 Co. Accordingly, Line D on Page 1 of the form must be checked. Further, Schedule O, Organization or Reorganization of Foreign Corporation, and Acquisitions and Dispositions of its Stock, to Form 5471 must be prepared to include the details regarding the Merger, *e.g.*, the date and method of disposition, number of shares and class of stock disposed, and consideration received.

U.S. CHARACTERIZATION OF THE GAIN ARISING FROM THE SALE OF GROUND FLOOR

In General

Generally, a U.S. Shareholder of a C.F.C. is subject to U.S. tax on a current basis on his or her *pro rata* share of the income of the C.F.C.[14] Broadly speaking, the income of a C.F.C. is categorized as either Global Intangible Low Taxed Income ("G.I.L.T.I.") and Subpart F income.

G.I.L.T.I. income refers to the operating income (after several adjustments) of a C.F.C. if it is engaged in an active trade or business. One noteworthy adjustment that is relevant to Sam and the C.F.C.'s he owns relates to depreciable assets. Operating income of a C.F.C. is reduced by 10% of the average of the quarterly adjusted basis of depreciable and amortizable assets used by the C.F.C. in its business. If a C.F.C. incurs a loss, its U.S. Shareholder is allowed to use his or her *pro rata* share of the loss to offset the G.I.L.T.I. income generated by other C.F.C.'s. Any excess loss that remains unused is lost; it cannot be used to reduce G.I.L.T.I. in any other year.

On the other hand, Subpart F income refers principally to the passive income such as Foreign Personal Holding Company Income (after reducing passive losses but not below zero) and certain intercompany income of a C.F.C., such as Foreign Base Company Sales or Services Income.

Gain Arising From the Sale of a Portion of the Hotel Premises

The treatment of the gain from the sale of Hotel X depends on the nature of the gain for U.S. tax purposes. In other words, the gain will be taxed as G.I.L.T.I. if it is treated

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[14] Amounts specifically removed from G.I.L.T.I. categorization include Subpart F Income (even if excluded by reason of the high-tax exception), income effectively connected with a U.S. trade or business, certain dividends received from a related person, and certain foreign oil and gas income.

as income from X_1 Co's operating business activity. On the other hand, the gain will be taxed as Subpart F income if it is treated as passive income.

Generally, Subpart F income includes dividends, interest, royalties, rents, annuities, and any gains on the sale of assets that give rise to such income.[15] On the other hand, a gain on the sale of an asset (including real property and intangible property) used in the C.F.C.'s trade or business does not give rise to subpart F income.[16]

G.I.L.T.I. income is the excess of the gross tested income over deductions properly allocable to the gross tested income.[17] The gross tested income is the gross income of the C.F.C. However, it excludes, *inter alia*, income taxed as Subpart F income.[18] As discussed above, a gain arising from the sale of an operating asset used in the trade or business of a C.F.C. is excluded from Subpart F income. Therefore, by reason of its exclusion from Subpart F income, it is treated as gross income for the purposes of calculating the gross tested income for G.I.L.T.I. purposes.

Under the present facts, the asset sold is a portion of Hotel X. Because the portion consisted of premises regularly made available to the guests of Hotel X, the property sold was regularly used in the hospitality business that was carried on by X. As a result, the gain from the sale of a portion of Hotel X is not Subpart F Income, but is included for the purposes of calculating gross income, gross tested income, and G.I.L.T.I.

"G.I.L.T.I. income is the excess of the gross tested income over deductions properly allocable to the gross tested income."

G.I.L.T.I. CALCULATIONS

Shareholder-by-Shareholder Calculation

G.I.L.T.I. is calculated at the level of a U.S. shareholder. This implies that, in order to calculate a U.S. shareholder's G.I.L.T.I. inclusion amount for a relevant year, the tested income of all of the income-generating C.F.C.'s in the year and the tested losses of all of the loss-making C.F.C.'s for the same year are aggregated. This exercise is performed on Schedule A of Form 8992 (*U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI)*). This has the effect of reducing the aggregate G.I.L.T.I. inclusion amount subject to U.S. tax in a year by the aggregate amount of tested losses from all of the loss-making C.F.C.'s.

As mentioned above, all corporations other than X Co incurred losses in 2022. X Co was profitable in 2022 due in large measure to the sale of a portion of the premises of Hotel X. Thus, the tested income of X Co can be offset against tested losses, if any, incurred by X_1 Co (through a day prior to the Merger), Y Co, and Z Co in 2022.

Ability to Offset the G.I.L.T.I. Gain by C.F.C. N.O.L.'s of Earlier Years

A U.S. Shareholder is not allowed to carry forward the net G.I.L.T.I. loss in one year to offset G.I.L.T.I. income in another year. In other words, the G.I.L.T.I. loss of a C.F.C. in a year is neither carried forward nor carried back. The tested loss of one

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15 Code §954(c)(1)(B)(i).

16 Treas. Reg. §1.954-2(e)(3)(iii)-(iv).

17 Treas. Reg. §1.951A-2(b)(1).

18 Treas. Reg. §1.951A-2(c)(1)(i).

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C.F.C. owned by a U.S. Shareholder for a year is allowed to offset the tested income of another C.F.C. owned by that U.S. Shareholder for the same year.

X Co is a C.F.C. Therefore, any net operating loss incurred by X Co in a year will not be allowed to be carried forward to future years for purposes of computing Sam's share of G.I.L.T.I. income for any such future year. As a result, X Co's N.O.L.'s (or the N.O.L.'s of Y Co and Z Co from earlier years) cannot be utilized to reduce Sam's G.I.L.T.I. inclusion in 2022.

FACTORS TO KEEP IN MIND REGARDING THE SALE OF A PORTION OF HOTEL X

Computation of Taxable Gain

The gain from the sale of a portion of Hotel X must be reported in U.S. Dollars for U.S. tax purposes. Therefore, the sale proceeds denominated in the currency of country A must be converted into U.S. $ using the exchange rate on the date of the sale. Additionally, all costs incurred by X Co to facilitate the sale will be taken into account in determining the net taxable gain of X Co. Examples include expenses to advertise the property, attorneys' fees, brokers' fees, and registration fees regarding to the sale.

Tax Rate on G.I.L.T.I.

For an individual, the G.I.L.T.I. income is taxed at ordinary rates of up to 37%, plus state and local tax in the state where Sam resides. A subsequent distribution by X Co to Sam of the G.I.L.T.I. income will not be subject to U.S. tax. However, if an election is made to characterize Sam as if he were a corporation for the sole purposes of computing U.S. tax on G.I.L.T.I. ("Code §962 election"), the effective rate of the G.I.L.T.I. tax can be reduced to 10.5%, reflecting the 21% rate of Federal income tax for corporations that is applied to a tax base reflecting a deduction of 50% of G.I.L.T.I. allowed to corporations. Individuals are not entitled to that deduction.

Once the net G.I.L.T.I. tax is computed after a Code §962 Election is made, an individual taxpayer may claim a credit equal to 80% of the foreign taxes paid by the C.F.C. on the G.I.L.T.I. income. For Sam, the foreign tax credit likely provides little or no benefit due to X Co's N.O.L., which eliminated corporate tax in Country A.

At some point when Sam receives a dividend from X Co, additional U.S. income tax will be due. If an income tax treaty is in effect with Country A, the U.S. Federal income tax will be imposed at a rate that does not exceed 20% assuming the dividend is a qualified dividend. In the absence of a tax treaty between the U.S. and Country A, the dividend will be subject to U.S. tax at ordinary rates of up to 37%. Net Investment Income tax of 3.8% will be imposed. State and local tax may also be imposed. However, Sam will be eligible to claim a credit for any dividend withholding tax that may arise in Country A on the dividend distribution.

In view of the above, making a Code §962 election will offer the following benefits:

- It will likely result in an overall lower tax liability (10.5% x 100% of G.I.L.T.I.) plus (20% of 89.5% of G.I.L.T.I.) plus (3.8% x 100% of G.I.L.T.I.) or 32.26%. In the absence of an election, the U.S. tax would be (37.5% x 100% of G.I.L.T.I.)

plus (3.8% of 100% of G.I.L.T.I.) or 40.8%.

- The election will allow deferral of the 20% tax liability plus the 3.8% N.I.I.T. to the year of an actual distribution.
- The election will allow Sam to claim a credit of the tax paid in Country A on actual distributions against his U.S. tax liability of 20%. In the absence of the election, the foreign tax may remain unused in the absence of any other source of foreign passive income.

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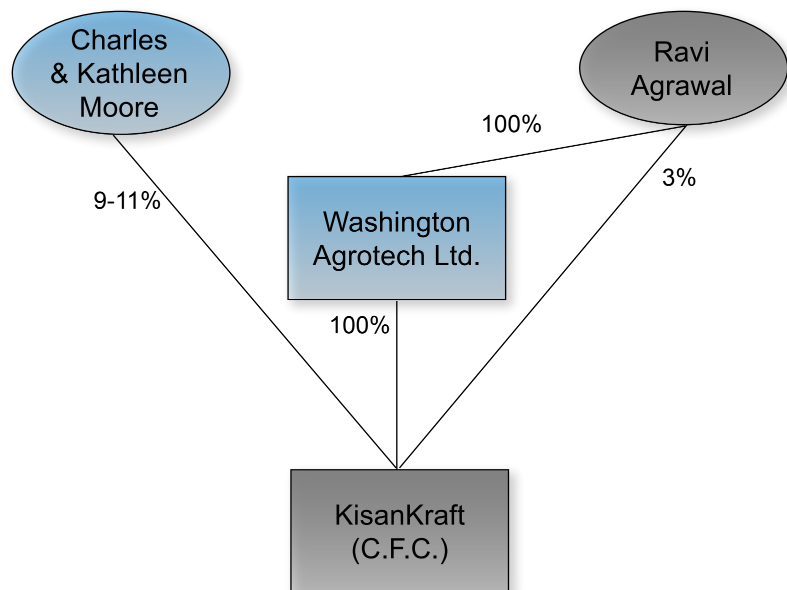
MOORE V. U.S. – A CASE FOR THE AGES TO BE DECIDED BY SUPREME COURT

Authors
Stanley C. Ruchelman
Wooyoung Lee

Tags
C.F.C.
D.R.D.
D.V.D.
Moore v. U.S.
Participation Exemption
Realization Requirement
Transition Tax

INTRODUCTION

The comedian, Mel Brooks, once uttered a quip for the ages: "It's good to be king!" The thrust of the statement was that those in power can do what they want. The Moore case challenges that notion when it comes to tax legislation by asking whether the Constitution of the U.S. places limits on the ability of Congress to tax what is essentially unrealized income.



THE CASE

The Facts

In 2006, Charles and Kathleen Moore invested $40,000 for an 11%[1] stake in KisanKraft Machine Tools Pvt. Ltd., an Indian corporation in the business of farming equipment. KisanKraft was founded and controlled by a friend of Moores, Ravi Agrawal. Mr. Agrawal held 3% of KisanKraft directly and 80% through a wholly owned U.S. corporation. Throughout the Moores' involvement with KisanKraft, the company retained all of its earnings and profits and never made a distribution to its shareholders. Nonetheless, the Moores were liable for a tax known as the "transition tax," a major element in the change of U.S. tax law applicable to direct investment by U.S. corporations in foreign subsidiaries.

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1 It appears the Moores' stake fluctuated between 9% and 11% during the relevant time period. "Records Show Moore's Interest in Transition Tax Company Changed." *Tax Notes*, Oct. 11, 2023.

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In very broad terms, prior law allowed a U.S. corporation owning at least 10% of a foreign corporation to claim an indirect foreign tax credit for corporate income taxes paid by the foreign corporation. This credit was allowed in addition to the credit allowed for dividends withholding taxes. In a chain of foreign corporations, the indirect foreign tax credit was allowed as dividends were distributed up the chain, so long as certain ownership thresholds were met. U.S. citizens and resident individuals could not claim the benefit of the indirect foreign tax credit.

The transition tax targeted previously deferred foreign earnings of certain foreign corporations with U.S. shareholders. It required a one-time increase in Subpart F income attributable to the deferred foreign earnings of certain U.S. shareholders. The tax applied to any 10% U.S. shareholder of a "controlled foreign corporation" ("C.F.C.") and foreign corporations with 10% U.S. corporate shareholders. A corporation that triggers either threshold and has deferred foreign earnings is known as "deferred foreign income corporation" ("D.F.I.C."). To incentivize compliance, Congress added deductions that reduce the tax rate to comparably favorable rates of 15.5% for cash and cash equivalents and 8% for all other assets.

The Moores were liable for the transition tax because they were 10% shareholders, and KisanKraft was a D.F.I.C. under either threshold (*i.e.*, it was a C.F.C. and had a 10% U.S. corporate shareholder in Washington Agrotech).[2]

THE LAWSUIT

Although the Moores failed to pay the transition tax in 2017 (when the tax was introduced and became due), they amended their tax return for that year and paid the tax. They then sued for a refund. The Moores based their objection on the "Apportionment Clause" of the Constitution, which requires that direct taxes be levied on states in proportion to the states' populations. While the Federal income tax is a direct tax that is not proportioned on the basis of state population, the 16th Amendment exempts income taxes from this requirement.

In the Moores' view, they had been passive investors who had yet to see any return on their investment. They argued that the tax was therefore a direct tax but not a tax on income, as they had not realized any income. As a direct non-income tax, they believed that, for the transition tax to be valid, it needed to satisfy the Apportionment Clause.

The Moores also found issue with the transition tax's retroactive nature: a D.F.I.C.'s earnings from as far back as 1986 are taxable to its shareholders under the transition tax. This, the Moores claimed, violated the Due Process Clause of the Fifth Amendment.

The apportionment argument stems from *Eisner v. Macomber*,[3] a famous tax case that is generally understood to stand for the realization requirement, or the idea that income cannot be taxed until it is realized by the taxpayer.[4] There, the Supreme

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[2] Note that a corporation only needs to meet one of these requirements to be a D.F.I.C.

[3] 252 U.S. 189 (1920).

[4] The principle in the decision remains in the general rule of Code §305 regarding *pro rata* stock dividends.

Court held that a stock dividend paid out from undistributed earnings and profits was not a realization event and therefore not taxable. But the district court in *Moore* observed that subsequent cases had limited the reach of *Macomber*. For example, *Dougherty v. Commr*.[5] upheld the Subpart F regime while noting that *Macomber* did not prevent Congress from looking past the corporate shell to determine taxable income.

There are other provisions of the Internal Revenue Code tax unrealized income, including, but not limited, to the following:

- Certain expatriates must pay an exit tax, calculated as if all of their assets were sold prior to expatriation.
- Some assets are taxed on a mark-to-market system as if they were sold at the end of each tax year, including regulated futures contracts, securities held by dealers, and certain assets held by life insurance companies.

These provisions have survived similar challenges.[6]

The Moores contended that the tax was not a tax on income – thereby sidestepping the issue of whether the income is realized – but a tax on property. Under this view, the transition tax differs from Subpart F in that Subpart F functions through constructive realization of income, *i.e.*, income realized by a foreign corporation while it is controlled by U.S. shareholders. The Moores distinguished Subpart F from the transition tax by characterizing the latter as a tax levied based on ownership of an asset. The Moores supported their argument with the observation that the tax rates differ depending on the form that the earnings are held in (cash versus other assets). The argument did not convince the district court.

"The court was more receptive to the Moores' argument against a retroactive tax. It accepted that the tax was retroactive and dismissed the government's arguments to the contrary, which the court characterized as absurd."

The court was more receptive to the Moores' argument against a retroactive tax. It accepted that the tax was retroactive and dismissed the government's arguments to the contrary, which the court characterized as absurd. But the court was less convinced that this constituted a violation of due process. It cited precedent under *U.S. v. Carlton*[7] that a retroactive tax was constitutionally acceptable if it was supported by a legitimate legislative purpose and furthered by rational means. The court accepted Congress's desire to prevent a windfall on deferred foreign earnings as a legitimate purpose.[8] The court further acknowledged that the T.C.J.A.'s move to a territorial tax system represented a large enough change that Congress was justified in taxing earnings dating back to 1986, when the Code underwent its last major revision.

In any case, the district court did not seem to give much weight to the timeframe. It analyzed the other factors in *Carlton* to determine whether there was a violation of due process:

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[5] 60 T.C. 917 (1973).

[6] Some commentators have warned of the collateral effects on these other provisions if the realization requirement is interpreted as the Moores believe. See "If Moore is Reversed." *Tax Notes*, June 26, 2023.

[7] 512 U.S. 26.

[8] See participation exemption below.

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- The transition tax is not a new tax but rather a modification to Subpart F, which weighed against a finding of due-process violation.
- The transition tax resolved uncertainty by (along with the rest of the T.C.J.A.) making clearer when foreign earnings would be taxed. This also weighed against there being a due-process violation.
- The Moores had had little notice of the transition tax's introduction, which is more suggestive of a due-process violation. But precedent suggested this was not dispositive.

Commenters have disagreed on the amount of notice that the Moores received and should have received. The transition tax was the subject of proposed legislation as early as 2014. But it is not clear that the Moores were the type of taxpayers who could reasonably be expected to pay attention to such developments. The Moores characterized their investment as charitably minded support for their friend and the public good, rather than a sophisticated and profit-oriented business venture. And the shift introduced by the T.C.J.A. was drastic. A C.F.C. that ran an active business would previously not been taxed on its undistributed earnings. The Moores, after learning about and paying the transition tax, sold enough shares to take them below 10% ownership. With more notice, they might have done this sooner.

On the other hand, absence of notice of an upcoming tax change has not been held to be an issue where the increased tax burden "result[s] from carrying out the established policy of taxation."[9] Under such broad language, it could be argued that the transition tax expanded on the antideferral policy already established by Subpart F. As U.S. shareholders in a C.F.C., the Moores had an obligation to report information on their ownership in KisanKraft using Form 5471. This might have made them more aware of the broader goal of Subpart F, even if they did not previously have any Subpart F income.

The district court ultimately granted the government's motion to dismiss the case. This result was affirmed by the 9th Circuit. The Supreme Court then granted *certiorari*.

HISTORY

The Moores focused their argument on the realization requirement, but the spotlight on the transition tax has invited comment on other issues related to the tax.

Participation Exemption Regime and D.R.D.

The background to the transition tax is intertwined with the U.S. system of worldwide taxation prior to the foreign-source D.R.D. that currently appears in Code §245A. Prior to the enactment of that section, the U.S. was one of the few countries that taxed foreign-source dividends received by domestic corporations and eliminated double taxation through the indirect foreign tax credit accompanied by a gross up of the dividend by amount of foreign creditable taxes that accompanied the dividend. In comparison, other countries provided a participation exemption for direct investment dividends received from foreign corporations, provided certain ownership requirements were met.

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9 *Milliken v. U.S.*, 283 U.S. 15.

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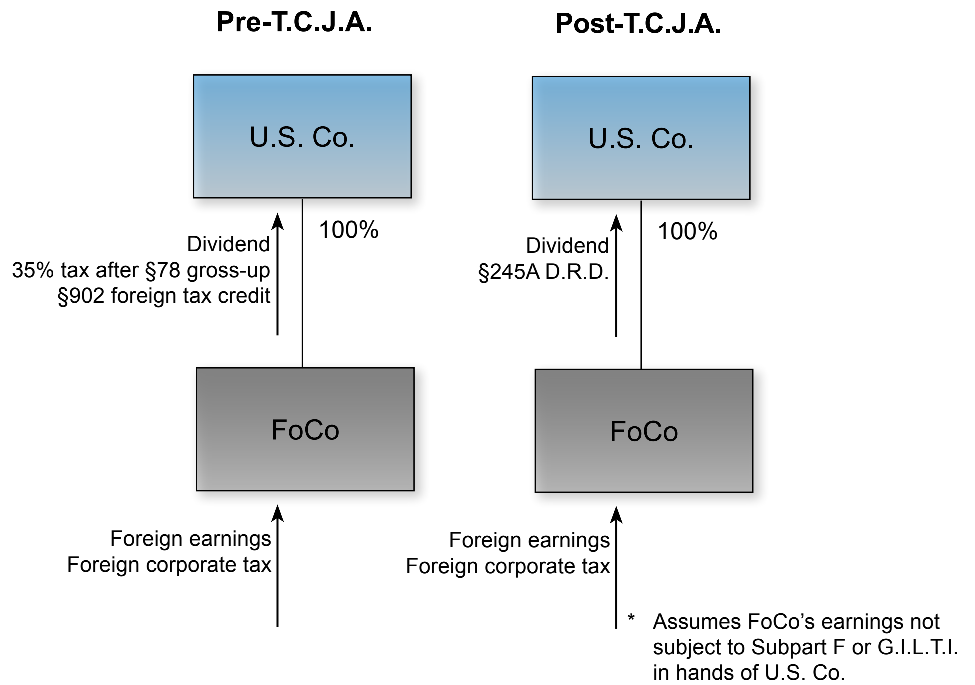
In 2017, Congress passed the Tax Cuts and Jobs Act ("T.C.J.A."). One effect was to move the U.S. to a participation exemption system through a new D.R.D. The new D.R.D. is contained in Code §245A. The D.R.D. is available if

- the recipient is a U.S. corporation,
- the recipient owns at least 10% of the payor,
- the payor is a foreign corporation,
- the dividend (or a portion thereof) is attributable to foreign earnings, and
- the recipient held the stock of the payor for more than 365 days in the 731-day period beginning on the date 365 days before ex-dividend date.[10]



Transition Tax

The T.C.J.A. also introduced the transition tax. Congress had multiple motives behind its enactment. As a transition to the new participation exemption regime, the tax was meant to prevent a windfall for U.S. corporations that would otherwise be able to repatriate deferred offshore earnings on a tax-free basis under the new system for dividends received from foreign 10%-owned foreign corporations.[10]

The transition tax was not restricted to corporate taxpayers. This is in spite of several indicators that limiting the tax to corporate shareholders would have been more appropriate:

- The transition tax was enacted as a supplement to the D.R.D. Individual shareholders do not benefit from the D.R.D. Consequently, there is no risk of a windfall from the move to a participation exemption system.

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10 Code §246(c)(5).

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- Foreign corporations that are not C.F.C.'s are D.F.I.C.'s only if there is at least one 10% shareholder that is a U.S. corporation.
- The effective tax rates of 15.5% and 8% are derived from corporate tax rates. Congress considered setting separate rates for individual shareholders but decided it would be meaningless because individuals could elect to be taxed as corporations under Code §962.[11]

It is not entirely clear to most commentators why Congress chose to include individuals. The Conference Report simply states, as follows:

> In contrast to the participation exemption deduction available only to domestic corporations that are U.S. shareholders under subpart F, the transition rule applies to all [10%] U.S. shareholders of a specified foreign corporation.

Washington insiders have speculated that the extension of the transition tax to individuals who are 10% shareholders of foreign corporations is thought to be a "pay-for," meaning the revenue generated was used to offset (or "pay for") the revenue that would be lost under other tax cuts adopted in the T.C.J.A..

FINAL COMMENTS

The application of the transition tax to individual shareholders may be conceptually unfair, but there is little doubt that this was the intent of Congress. The Treasury Department, in denying practitioners' request for an exemption for individual shareholders, reaffirmed this in the preamble to the §965 proposed regulations, in the following language:

> Because the statute and legislative history are clear that section 965 was intended to apply to all United shareholders, including individuals, the Treasury Department and the IRS have determined that providing the requested relief is not appropriate.[12]

It is not likely that Congress, the Treasury, or the I.R.S. will change their views on the transition tax. The statute will not be rewritten to remove individual shareholders from coverage of the transition tax. However, the Supreme Court agreed to hear the challenge of the Moores.

To date, many pundits have attacked the arguments in favor of the Moores' position, commenting that it could wreak havoc on multiple provisions of the Code. Other experts have pointed to the plethora of provisions that accelerate tax of shareholders before an actual receipt of dividends.

Nonetheless, the final chapter of the saga has not yet been written. How the Supreme Court will rule is anybody's guess.

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[11] H.R. Rep. No. 115-466, p. 620.

[12] 83 FR 39514, at 39538.

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CHRISTENSEN V. U.S. – REDUCING THE N.I.I.T. BY CLAIMING AN F.T.C.

Author
Michael Bennett

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Net Investment Income Tax
Toulouse

INTRODUCTION

The reliance on smartphone G.P.S. applications is nearly ubiquitous in today's world. These "map apps" not only furnish diverse routes to destinations but routinely identify roadblocks and traffic disruptions, ensuring the selection of the most efficient route. Like a map app, the *Christensen* case delineated two distinct paths for taxpayers to claim a foreign tax credit ("F.T.C.") – either through the Internal Revenue Code (the "Code") or an applicable income tax treaty. As highlighted in the case, one pathway may be a backroad gem when the other is blocked.

In *Christensen*, the Federal Claims Court allowed U.S. citizen/French tax resident taxpayers to claim the F.T.C. to reduce the net investment income tax ("N.I.I.T.") using Article 24(2)(b) of the France-U.S. Income Tax Treaty ("France-U.S. Treaty").[1] This approach countered the Code's explicit disallowance of the F.T.C. as a way to reduce the N.I.I.T. The Federal Claims Court decision built upon the Tax Court's previous decision in *Toulouse*, where the Tax Court denied an F.T.C. claimed against the N.I.I.T. by a U.S. citizen/French resident taxpayer.[2] The disparity in outcomes did not stem from a conflict in reasoning. Rather, it resulted from the application of different provisions of the treaty. The taxpayer in *Toulouse* relied solely on Article 24(2)(a). The taxpayer did not raise the Article 24(2)(b) argument presented in *Christensen*. This simple change made all the difference and reinforced the principle that an income tax treaty can serve as the source of an F.T.C.

The decision proves timely, considering the N.I.I.T. applies to tax years beginning in 2013, and the statute of limitations for an F.T.C. claim is ten years.[3] Accordingly, the deadline for filing an amended return for the inaugural N.I.I.T. year is April 15, 2024.

An appeal by the U.S. is anticipated, but as of now, the *Christensen* decision has opened an avenue for U.S. citizens residing in a treaty jurisdiction to pursue an F.T.C. claim in order to reduce liability for the N.I.I.T. The unfolding of time will determine the degree to which taxpayers are broadly allowed to adopt this new path or if the U.S. successfully closes it. If the case is not reversed on appeal, the only course of action to prevent taxpayers from claiming the F.T.C. would involve a bilateral revision to the French Treaty or a unilateral revision to U.S. tax law for the sole purpose of removing the benefit.

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1. *Christensen v. United States*, No 20-935T (2023).
2. *Toulouse v. Commr.,* 157 T.C. No. 4 (2021).
3. Code §6511(d)(3)(A).

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NET INVESTMENT INCOME TAX

The N.I.I.T. is a separate levy from the regular income tax imposed on investment income under Chapter 1 of the Code. The N.I.I.T. under Code §1411 appears in its own separate chapter in the Code, Chapter 2A "Unearned Income Medicare Contribution." It first came into effect in 2013 as a means to fund the Affordable Care Act, which is the health care reform law enacted under the Obama administration. Code §1411 imposes a 3.8% tax on individuals on the lesser of net investment income or the excess, if any, of modified adjusted gross income over specified thresholds. Investment income includes interest, dividends, capital gains, rents, royalties, and other types of passive income. The tax typically is owed by higher-income taxpayers who earn a higher proportion of their income from investments.

FACTS OF THE CASE

Christensen involved a married couple, Matthew and Katherine Kaess Christensen, both U.S. citizens living in Paris and classified as tax residents of France. The couple timely filed their 2015 U.S. Federal income tax return and reported the following categories of income:

- Earned income of $369,373
- U.S. source passive income of $7,976
- Foreign source passive income of $101,353

Prior to factoring in any foreign tax credits, the couple faced a $76,376 U.S. Federal income tax liability under Chapter 1 of the Code. The couple also paid N.I.I.T. of 3.8% on both their U.S. source and foreign source passive income, which resulted in N.I.I.T. of $4,155. Of that amount, $3,851 related to foreign source passive income and the remaining $304 was attributed to U.S. source passive income. France exclusively taxed the foreign source portion of their investment income.

In the originally filed tax return, the Christensens did not claim an F.T.C. for either portion of N.I.I.T. In 2020, they filed an amended return claiming an F.T.C. against the N.I.I.T. attributed to their foreign source passive income. This resulted in a claim for a refund of $3,851.

The couple attached Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) to their amended tax return to disclose the basis of their position and refund claim. In relevant part, the couple asserted that Article 24 of the France-U.S. Treaty permitted an F.T.C. against the N.I.I.T. imposed on foreign source passive income. The I.R.S. denied the refund claim, resulting in a substantial 33.8% effective tax rate on their foreign source passive income (30% French capital gain rate plus the 3.8% N.I.I.T. rate). An F.T.C. was allowed against the "regular" income taxes due under Chapter 1 of the Code.

Because U.S. tax was already paid, the Christensens initiated legal proceedings in the U.S. Court of Federal Claims. The U.S. Tax Court did not have jurisdiction.

TAXPAYERS' POSITION

The Christensens acknowledged that the Code does not provide for an F.T.C. against the N.I.I.T. The origin of the F.T.C. is found in Code §27, which provides as follows:

> The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax imposed by [Chapter 1] to the extent provided in section 901.

Code §901 provides that the tax imposed by Chapter 1 can be reduced by a credit for foreign income taxes. It provides as follows:

> If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) * * *.

". . . the court asserted its responsibility to interpret the Treaty in line with the shared expectations of both the U.S. and France."

The relevant portion of subsection (b) provides the following:

> (1) Citizens and domestic corporations.
>
> In the case of a citizen of the United States * * *, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States * * *.

It is crucial to note that the N.I.I.T. does not fall under Chapter 1 but rather resides in Chapter 2A of the Code; hence the lack of availability of an F.T.C. against the N.I.I.T. strictly through the Code. Nonetheless, the couple argued that the F.T.C. was available against the N.I.I.T. under the France-U.S. Treaty either under paragraph (2)(a) or (2)(b) of Article 24.

D.O.J. POSITION ON BEHALF OF THE I.R.S.

The Department of Justice ("D.O.J."), representing the I.R.S. in the case, contended that the court should afford deference to the U.S.'s interpretation of the France-U.S. Treaty. However, the court asserted its responsibility to interpret the Treaty in line with the shared expectations of both the U.S. and France.

The D.O.J. argued that the French government acquiesced to the U.S. interpretation, specifically that no F.T.C. is allowed for the N.I.I.T. under the France-U.S. Treaty. To support this assertion, the D.O.J. sought reliance on the interpretations of the Treaty issued by the U.S. Treasury Department, namely the Technical Explanation prepared by the I.R.S. at the time the treaty was submitted to the Senate for approval. The D.O.J. also referred to the 2004 Protocol and the 2009 Protocol to the France-U.S. Treaty and the U.S. Model Treaty in various iterations.

HOLDING OF THE FEDERAL CLAIMS COURT

The Federal Claims Court refused to consider the Treasury Department's interpretations, as it solely represented the U.S. viewpoint and lacked any indication that it played a role in the negotiations. This marked a departure from the Tax Court

approach in *Toulouse*, where deference was accorded to the Technical Explanation of the France-U.S. Treaty.

The court pointed out the lack of certainty on whether France had an opportunity to object, or indeed objected, to the U.S. interpretation of the Treaty, as it related to the N.I.I.T. No evidence was presented that the U.S. "notified" the French government of the enactment of the N.I.I.T. The court expressed that it should not presume France's concurrence with the U.S. viewpoint based solely on the absence of any indication as to the French government's position. Silence is not acquiescence when governments are involved. Due to the lack of evidence regarding the French government's position, the court could not defer to the U.S. position as to the F.T.C.

When provisions of a treaty and of a statute appear inconsistent, the Supreme Court has consistently held that, if possible, the two provisions should be harmonized to the maximum extent possible to avoid an actual conflict.[4] The D.O.J. contended for a later-in-time rule, asserting that when Congress enacts a statute with terms incongruent to a preexisting treaty, the statute's text alone suffices to demonstrate Congress's intent to override the treaty. In addition, the D.O.J. maintained that, if the Court were ever required to break a tie between two equally plausible interpretations of the Treaty – one permitting a tax credit and the other denying it – the tax credit should be denied consistent with domestic tax credit principles.

The court remained unpersuaded. Under the Constitution, a treaty is accorded the same status as an act of the legislature, and the later-in-time rule does not prevail if the treaty stipulation is not self-executing. Instead, the court embraced the perspective that the treaty should be liberally construed, favoring an interpretation that broadens the rights that may be claimed under a treaty.

The court also took into consideration Treasury Decision 9644, which specifically addressed the question of whether the N.I.I.T. is eligible for F.T.C.'s, with a focus on income tax treaties entered into by the U.S. According to the Treasury Decision, the N.I.I.T. is categorized not as a Chapter 1 tax and is, therefore, ineligible for credits under Code §§27 and 901, as pointed out in Treas. Reg. §1.1411-1(e).

The decision addresses whether U.S. income tax treaties can provide an independent basis for crediting foreign taxes against the N.I.I.T.:

> The Treasury Department and the [I.R.S.] do not believe that these regulations are an appropriate vehicle for guidance with respect to specific treaties. An analysis of each United States income tax treaty would be required to determine whether the United States would have an obligation under that treaty to provide a credit against the section 1411 tax for foreign income taxes paid to the other country.

The Treasury also recognized that if a treaty solely contains language similar to Article 23(2) of the 2006 U.S. Model Treaty (which is virtually the same as Article 24(2)(a) of the France-U.S. Treaty), the treaty would not provide an independent basis for a credit against the N.I.I.T.

By indicating that treaty provisions other than those similar to Article 23(2) of the 2006 U.S. Model Treaty, could provide a credit, the Treasury opened the door for applying the F.T.C. against the N.I.I.T.

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[4] *Weinberger v. Rossi*, 456 U.S. 25, 32 (1982).

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COMPARISON WITH THE *TOULOUSE* CASE

The Federal Claims Court examined the holding in *Toulouse*. In *Toulouse*, the Tax Court scrutinized the permissibility of claiming an F.T.C. against the N.I.I.T. under both the France-U.S. Treaty and the Italy-U.S. Income Tax Treaty. However, in *Toulouse*, the taxpayer asserted only an entitlement to an F.T.C. under Article 24(2)(a) and omitted any reference to Article 24(2)(b). The Tax Court's verdict in *Toulouse* rested on the determination that Article 24(2)(a) did not authorize an F.T.C. against the N.I.I.T. due to the "provisions" and "limitations" language, which established a link between the treaty and the relevant Code provisions limiting F.T.C.'s to Chater 1 taxes, as discussed below.

Article 24(2)(a) of the France-U.S. Treaty provides as follows in relevant part:

> In accordance with the *provisions* and subject to the *limitations* of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a citizen or a resident of the United States as a credit against the United States income tax: the French income tax paid by or on behalf of such citizen or resident.

The taxpayers argued that the "provisions" and "limitations" language specifically pertained to the basket limitations under in Code §904. However, the Federal Claims Court observed that the Treaty provision did not explicitly mention Code §904, nor could an exclusive reference to Code §904 be inferred solely from the use of "limitations." Emphasizing that the terms "provisions" and "limitations" encompassed a broad scope, the court indicated that F.T.C.'s were subject not only to the limitation of Code §904 but also to the provisions of the Code, including Code §§27 and 901. Consequently, the Tax Court rejected the couple's assertion that an F.T.C. was available for the N.I.I.T. under Article 24(2)(a), pointing out that Code §27 and 901 precluded an F.T.C. for taxes arising outside of Chapter 1.

This conclusion aligned with the holding in *Toulouse*. Like T.D. 9644, though, the *Toulouse* court left the door open for a possible Article 24(2)(b) argument. While denying a treaty based F.T.C. against the N.I.I.T. under Article 24(2)(a), the *Toulouse* court stated:

> Petitioner questions the purpose of the Treaties if there is no independent, treaty-based credit and a credit is allowable only if it is provided in the Code. But we do not so hold. Other provisions of the Treaties may well provide for credits that are unavailable under the Code. Petitioner, however, relies on provisions that by their express terms do not.

Article 24(2)(b) permits an F.T.C. for U.S. citizens resident in France. However, it does not include the language referencing the "provisions" and "limitations" of U.S. law. Accordingly, the Christensens contended that this provision does not trigger Code §§27 and 901.

To independently interpret paragraph 2(b) of Article 24 of the Treaty from paragraph 2(a), the court emphasized the need to harmonize the Treaty with the Code without conflict. Adhering to the principle that an act of Congress should not be construed to violate the law of nations if any other possible construction is available, the court

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construed the Treaty liberally and upheld the shared expectations of the U.S. and France regarding Article 24(2)(b).

The court rejected the position of the D.O.J. that an inference should be drawn that Congress intended to exclude the N.I.I.T. from all foreign tax credits from its placement in Chapter 2A. None of Code §§27, 901, and 1411 should be interpreted in a way that is contrary to the international obligations of Article 24(2)(b). Rather, Article 24(2)(b) should be interpreted to permit its own F.T.C.'s in a way that is independent of Code §§27 and 901.

The court determined that Code §27 should be read to impose a Chapter 1 restriction on the F.T.C. only to the extent the F.T.C. arises from Code §901. This interpretation contemplates the existence of an F.T.C. not bound to Chapter 1 when the F.T.C. obligation originates outside the Code. Code §904 can be read to apply only when the F.T.C. is taken under section 901(a). This implies the existence of F.T.C.'s that are not restricted to those taken against taxes imposed by Chapter 1, as they arise from sources other than the Code.

"The court rejected the position of the D.O.J. that an inference should be drawn that Congress intended to exclude the N.I.I.T. from all foreign tax credits merely because of the placement from its placement in Chapter 2A."

This interpretation of Code §§27 and 904 mitigates a potential conflict between the Code and the Treaty, recognizing the presence of two distinct categories of F.T.C.'s in U.S. law: statutory F.T.C.'s under Code §901 restricted to Chapter 1 taxes, and treaty F.T.C.'s not bound by Code restrictions unless specified by the treaty. Because an F.T.C. arising under Article 24(2)(b) of the France-U.S. Treaty is not a credit taken under Code §901, it may be claimed in regard to taxes arising outside of Chapter 1, such as the N.I.I.T.

This differentiation between Code-based and treaty-based F.T.C.'s finds additional support under Code §6511(d)(3)(A), which applies a 10-year statute of limitations for claiming an F.T.C. as a result of an adjustment to foreign income taxes made by a foreign tax authority. It provides as follows:

> Special period of limitation with respect to foreign taxes paid or accrued. If the claim for credit or refund relates to an overpayment attributable to any taxes paid or accrued to any foreign country or to any possession of the United States for which credit is allowed against the tax imposed by subtitle A in accordance with the provisions of section 901 *or the provisions of any treaty to which the United States is a party*, in lieu of the 3-year period of limitation prescribed in subsection (a) , the period shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued. [Empasis added.]

The use of the disjunctive "or" distinguishes an F.T.C. under the Code from an F.T.C. under a treaty.

In sum, the court concluded that Article 24(2)(b) of the France-U.S. Treaty enables the couple to claim an F.T.C. against the N.I.I.T., aligning with the apparent shared intent of the U.S. and France within the principles of treaty interpretation law and without conflicting with relevant provisions of the Code.

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CONCLUSION

The *Christensen* case illuminates the complexity of navigating F.T.C.'s, particularly concerning the N.I.I.T. The court's careful consideration of treaty interpretation principles and the distinction between Code-based and Treaty-based F.T.C.'s provides insights for high-income U.S. taxpayers resident in treaty jurisdictions. The holding reconciles the conflicting outcome in *Toulouse* by relying on a different provision of the France-U.S. Treaty. The timing of this case is noteworthy, as the statute of limitations for F.T.C. claims spans ten years. Considering that the N.I.I.T. applies to tax years commencing after December 31, 2012, the deadline for filing an amended return for the inaugural N.I.I.T. year extends to April 15, 2024. Even though the D.O.J. is likely to appeal, this decision has the potential to unleash a wave of refund claims from taxpayers residing in treaty jurisdictions.

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Author
Wooyoung Lee

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C.T.A.
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Tax Treaty

TAXPAYER PREVAILS IN F.B.A.R. CASE

Aroeste v. United States[1] is a court case that previously drew attention because the court, based on a plain reading of statutory language, overturned I.R.S. policy that residency under tax treaty does not affect F.B.A.R. filing obligations. The taxpayers were U.S. permanent residents, which would subject them to the F.B.A.R., but qualified as Mexican residents under the tiebreaker provision in the Mexico-U.S. tax treaty. The I.R.S.'s long-standing position is that treaty tiebreakers do not create an exemption from F.B.A.R. filing. Earlier in the case, the I.R.S. attempted to block discovery of evidence related to the treaty, arguing that it was irrelevant to F.B.A.R. considerations.[2] The court overruled the I.R.S. and pointed out that the F.B.A.R. regulations directly cross-reference the residency provisions in the Internal Revenue Code, which in turn take treaty tiebreakers into account. The case has now moved onto summary judgment. Reflecting the court's previous analysis, the court granted summary judgment to the taxpayers and nullified $22,000 of the taxpayers' F.B.A.R.-related penalties, although they still owe $2,000 in penalties due to late filing regarding the treaty position. The next step is whether the government will appeal the decision.

TAIWAN TAX-TREATY BILL

Earlier this year, two Senate committees (Foreign Relations and Finance) unveiled bills to effectively create a tax treaty with Taiwan.[3] While Taiwan is a *de facto* independent country, its unique status prevents it from signing a conventional tax treaty with the U.S. Instead, the legislation would add a new Code §894A to domestic law that imitates the effects of a treaty. The adoption of the pseudo-treaty would depend on Taiwan adopting corresponding rules in its domestic tax law. Now, new legislation that takes parts of both Senate committee bills has been introduced in the House Ways and Means Committee. The bill enjoys rare bipartisan support, and its introduction for full floor votes and its passage may be sooner rather than later.

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1 No. 3:22-cv-00682 (S.D. Cal. 2023).

2 No. 22-cv-682-AJB-KSC. This case was previously covered on *Insights* Vol. 10 No. 2.

3 Previously covered on *Insights* Vol. 10 No. 5.

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C.T.A.: NEW COMPANIES GIVEN EXTENSION TO FILE

One major change in reporting requirements for 2024 is the Corporate Transparency Act (C.T.A.), which will require companies to report their ultimate beneficial owners to FinCEN. While preexisting companies have a year to file reports, companies formed in 2024 would have had 30 days after formation to file. Final regulations issued by FinCEN now give newly formed companies 90 days to file.[4] The extension was granted after complaints that 30 days was insufficient, although some commenters believe even more time should have been granted. This extension is only effective for 2024, and companies formed in 2025 and later will still only have 30 days to report.

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[4] RIN 1506-AB62.

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Location

Architects and Designers Building | 150 East 58th Street, 22nd Floor | New York, New York 10155

Contacts

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

Galia Antebi	antebi@ruchelaw.com	+1 212.755.3333 x 113
Michael Bennett	bennett@ruchelaw.com	+1 212.755.3333 x 123
Nina Krauthamer	krauthamer@ruchelaw.com	+1 212.755.3333 x 118
Wooyoung Lee	lee@ruchelaw.com	+1 212.755.3333 x 121
Michael Peggs	peggs@ruchelaw.com	+1 212.755.3333 x 232
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
Daniela Shani	shani@ruchelaw.com	+1 212.755.3333 x 127

Editorial Staff

Stanley C. Ruchelman .... Editor in Chief
Francesca York .... Graphic Designer

WITH PHOTOS BY:
Galia Antebi, Jennifer Lapper, Simon Prisk, Stanley C. Ruchelman, and Francesca York.

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