Foreign Persons Investing in U.S. Real Estate: Partnership and Other Structures, Opportunities and Traps

NYU Summer Institute in Taxation: Advanced International Tax

July 23, 2015

Alan I. Appel	New York Law School
Michael Hirschfeld	Dechert LLP
Philip R. Hirschfeld	Ruchelman P.L.L.C.
Jeffrey L. Rubinger	Bilzin Sumberg

Principal Topics

- Building Blocks
- Planning Considerations and Alternative Structures – Real Estate
- Use of Debt
- Shared Appreciated Mortgages
- REIT Structures
- Foreign Sovereign Exemption
- Unwinding Corporate Structure
- Repatriation Strategies
- Planning with Treaties with Derivative Benefit Provisions

NUMBER P7514

SHARES -50-

A CORPORATION ORGANIZED UNDER THE LAWS OF DELAWARE

THE PITTSBURGH AND LAKE ERIE RAILROAD COMPANY

This Certifies that -LEWIS H. HITZROT- is the owner of

SEE REVERSE FOR CERTAIN DEFINITIONS

-FIFTY-

FULLY PAID AND NON-ASSESSABLE SHARES OF THE COMMON STOCK OF

THE PITTSBURGH AND LAKE ERIE RAILROAD COMPANY *transferable on the books of the Company in person or by duly authorized attorney upon surrender of this Certificate properly endorsed. This Certificate is not valid until countersigned by the Transfer Agent and registered by the Registrar.*

Witness the seal of the Company and the signatures of its duly authorized officers.

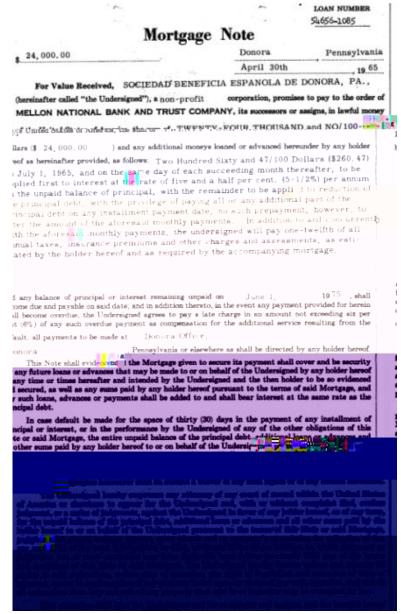
Dated: OCT 11 1967

TREASURER

PRESIDENT

COUNTERSIGNED PITTSBURGH NATIONAL BANK

REGISTERED MELLON NATIONAL BANK AND TRUST COMPANY



LOAN NUMBER 54656-1085

Mortgage Note

$ 24,000.00

Donora, Pennsylvania

April 30th, 1965

For Value Received, SOCIEDAD BENEFICIA ESPANOLA DE DONORA, PA., **(hereinafter called "the Undersigned"), a** non-profit **corporation, promises to pay to the order of MELLON NATIONAL BANK AND TRUST COMPANY, its successors or assigns, in lawful money** of United States of America, the sum of TWENTY-FOUR THOUSAND and NO/100-

...llars ($ 24,000.00) and any additional moneys loaned or advanced hereunder by any holder ...eof as hereinafter provided, as follows: Two Hundred Sixty and 47/100 Dollars ($260.47) ... July 1, 1965, and on the same day of each succeeding month thereafter, to be ...plied first to interest at the rate of five and a half per cent. (5-1/2%) per annum ... the unpaid balance of principal, with the remainder to be applied to reduction of ...e principal debt, with the privilege of paying all or any additional part of the ...incipal debt on any installment payment date, no such prepayment, however, to ...ter the amount of the aforesaid monthly payments. In addition to and concurrently ...th the aforesaid monthly payments, the undersigned will pay one-twelfth of all ...nual taxes, insurance premiums and other charges and assessments, as esti...ated by the holder hereof and as required by the accompanying mortgage.

...d any balance of principal or interest remaining unpaid on June 1, 1975, shall ...come due and payable on said date; and in addition thereto, in the event any payment provided for herein ...ll become overdue, the Undersigned agrees to pay a late charge in an amount not exceeding six per ...t (6%) of any such overdue payment as compensation for the additional service resulting from the ...fault, all payments to be made at Donora Office, ...onora, Pennsylvania or elsewhere as shall be directed by any holder hereof.

This Note shall evidence and the Mortgage given to secure its payment shall cover and be security ... any future loans or advances that may be made to or on behalf of the Undersigned by any holder hereof ...any time or times hereafter and intended by the Undersigned and the then holder to be so evidenced ...d secured, as well as any sums paid by any holder hereof pursuant to the terms of said Mortgage, and ...y such loans, advances or payments shall be added to and shall bear interest at the same rate as the ...ncipal debt.

In case default be made for the space of thirty (30) days in the payment of any installment of ...ncipal or interest, or in the performance by the Undersigned of any of the other obligations of this ...te or said Mortgage, the entire unpaid balance of the principal debt, additional loans or advances and ...other sums paid by any holder hereof to or on behalf of the Undersi...

Two U.S. Tax Regimes May Apply

- **Passive Income**: FDAP Income from U.S. Sources
  - 30% tax on “gross income”
    - U.S. payor withholds tax
    - Subject to reduction or elimination by (i) Tax Treaty or (ii) Code exemption (e.g., portfolio interest)
- **Active Income**: ECI Income
  - If engaged in U.S. trade or business (ETB) then income effectively connected (ECI) with that business is subject to U.S. income tax
    - Must file U.S. tax return

      Tax imposed at graduated rates (NRA is eligible for long-term capital gains rates)

      Tax imposed on “net income” so get deductions to lower tax liability
    - Branch profits tax may apply to non-US corporations

Rental Income

- Rental income: **FDAP** income subject to 30% withholding tax
- Tax can be very harsh
  - Example:
    - Lessee pays $100 rent to owner and lessee pays expenses to 3rd parties related to the property of $100 (e.g., real property taxes, insurance)
    - Gross rental income = $200
    - Withholding tax = $60
    - Net cash owner gets = $40 ($100 - $60)
    - Effective tax rate of 60%

Rental Income (cont'd)

- If leasing or other activity in relation to property makes foreign owner **ETB,** then rental income becomes **ECI**
- Tax *only* on "net income" from property, which is usually produces lower tax for owner
  - Example:
    - Lessee pays $100 rent to owner and lessee pays expenses related to the property of $100
    - Gross rental income = $200
    - Net rental income (before depreciation & interest deductions) = $100
    - Maximum Tax (assuming no depreciation or interest) = $35
    - Effective tax rate = 35% and lower if get depreciation, interest & other deductions
  - Owner must file tax return

Rental Income (cont'd)

- When does leasing make foreign owner **ETB**?
  - General Rules:
    - Rental of one property to one tenant under a "net" lease is not ETB

      See Rev. Rul. 73-522; *Neill*
    - Rental to many tenants is ETB

      See *Pinchot* (11 real estate properties)
  - Election to be ETB: §871(d), 882(d)
    - Often recommended since lower tax burden (due to deductions)
- If rental income is ECI, give Form W-8ECI to lessee to eliminate withholding tax

Sale of Real Estate

- Gain is Taxable: Foreign Investment in Real Property Tax Act of 1980 (**FIRPTA**) – §897
  - Gain from sale of "United States real property interest" ("USRPI") taxed as if:
    - Foreign seller is engaged in a trade or business in the U.S. & the gain is effectively connected with that trade or business
  - Foreign sellers are taxed on gains at the same rates applicable to U.S. sellers
    - Gain can qualify for long-term capital gains treatment
    - Like kind exchange treatment does not apply *unless* the seller receives U.S. property in the exchange – §1031(h)

Sale of Real Estate (cont'd)

- Definition of USRPI (Treas. Reg. § 1.897-1)
  - Interest in real property:
    - Real property includes land, buildings, and other improvements

      Includes growing crops and timber, and mines, wells and other natural deposits – but once extracted or severed, crops, timber, ores, minerals, etc. are no longer USRPIs

      Includes "associated personal property"

      Includes direct or indirect right to share in appreciation in value, gross or net proceeds or profits from real property
    - Does not include mortgage loan at fixed rate of interest (or variable rate such as prime, LIBOR, etc.)
  - Interest in domestic corporation that was a U.S. real property holding corporation (USRPHC – see later slide) at any time during the 5-year period preceding sale

Sale of Real Estate (cont'd)

- Withholding Requirement: §1445
  - Buyer must withhold 10% of "Amount Realized" on Sale
- Problem: Overwithholding
  - Example:
    - Sell real estate with a tax basis of $900 for $1,000
    - Buyer must withhold $100 tax (10% of $1,000) even though gain is only $100 & tax will be less than that
  - Solution: Get Exemption or reduced rate certificate by filing Form 8288-B before the sale
- Rev. Proc. 2000-35 explains this
- Recommende0.4EMC /P0S-2(alm)-3(lae)5($a)-2(lov-3

wthholding

Sale of Real Estate (cont'd)

- Other Exemptions to Withholding:
  - Non-recognition rules can apply
    - Domestication of a foreign corporation that owns US real estate under §897(e)
    - Contribution of US real estate to a newly formed US company under §897(e)
    - §1031 Like kind exchange of US real estate for other US real estate under §897(e)
    - §355 spin-offs may work under §897(d)

Dividend from U.S. Corporation

- **Dividend income**:
  - FDAP income subject to 30% withholding tax
    - Subject to reduction or elimination: Tax Treaties
- **Non-dividend distributions:**
  - If corporation is a USRPHC, as discussed below, withhold 10% of the distribution - §1445(e)(3)
    - Subject to reduction if go to IRS to obtain exemption or reduced rate certificate
- **REIT Dividends:**
  - Special rules discussed later

Sale of Stock of U.S. Corporation

- <u>Normal rule</u>: Gain from sale is not U.S. source FDAP income and does not make investor ETB
- <u>FIRPTA</u>: Taxable if sell stock of a U.S. Real Property Holding Corporations (USRPHC)
  - Treats the gain as ECI income
  - Corporate sellers also have branch profits tax

Sale of Stock (cont'd)

- USRPHC definition (§897(c)(2)):
  - FMV of USRPIs held on any "applicable determination date" equals or exceeds
    - 50% of sum of FMVs of (i) USRPIs; (ii) non-U.S. real property interests; and (iii) other trade or business assets
  - Look-through rule for assets held through entities
    - For corporations, only look-through if own more than 50%
- Exemption:
  - Regularly traded class of stock if taxpayer owns 5% or less
  - Does not include stock in a corporation that has sold all of its USRPIs in taxable transactions

Interest Income from U.S. Mortgage

- Interest income is **FDAP** income subject to 30% withholding tax
- Elimination under:
  - Portfolio Interest Exemption- §§ 871(h), 881(c) applies to all interest if debt is in registered form except:
    - Loan by foreign bank in the ordinary course of business
    - Loan from 10% or greater shareholder or partner
    - Contingent interest
    - HIRE Act of 2010 eliminated exception for post-3/18/2010 instruments in bearer form
  - Tax Treaties
    - Almost all treaties provide for exemption or reduced rate

Interest Income (cont'd)

- Issue: Can a foreign lender be ETB?
  - **"Buy" outstanding mortgages:** No
  - **"Originate" or make new loans:** Yes, if lender makes many loans in the U.S. and are therefore conducting a lending business in the U.S. (looks like a bank)
- If ownership of mortgages makes lender ETB, then portfolio interest exemption will not apply
  - Must file U.S. tax return and pay tax on net income from lending business
- Issue: How is interest from foreign seller financing of real estate sale taxed?
  - Not taxable under FIRPTA
  - Either FDAP income or (less commonly) ECI, whether or not sale that generated the note is taxed under FIRPTA

Sale of U.S. Mortgage

- General rule: Gain from sale is not U.S. source FDAP & not ECI
- Exception:
  - If in U.S. lending business then gain from sale would be ECI and therefore taxable
  - If mortgage loan has contingent interest then the loan is a USRPI and gain from its sale will be taxable under FIRPTA
- Example: Loan has 5% fixed interest and contingent interest = 25% of cash flow from the property

FATCA & REAL ESTATE

FATCA: Application to Real Estate

- FFI: 30% withholding on withholdable payments under §1471 will be imposed unless FFI:
  - Signs agreement with IRS (“PFFI Agreement”);
  - Is resident of country that has signed a FATCA IGA;
  - Is exempt from FATCA under existing IRS guidance
- NFFE: 30% withholding on withholdable payments under §1472 will be imposed unless NFFE:
  - Certifies that it has no substantial U.S. owner”; or
  - Provides the name, address, and TIN of each substantial U.S. owner; and
  - In either case, withholding agent (a) neither knows nor has reason to know certification is incorrect and (b) provides the substantial U.S. owner to IRS

FATCA: Application to Real Estate (cont'd)

Withholdable payments – real estate-related income:

- FDAP:
  - U.S.-source interest (e.g., interest from mortgage loan),
  - Dividends (e.g., dividend from USRPHC),
  - Rents and other types of payments from the U.S. (e.g., rent on U.S. real estate)
- U.S. Securities:
  - Gross proceeds from the sale of any property that could produce U.S.—source dividends or interest
  - This includes USRPHC stock and loan principal repayments from a U.S. borrower

ESTATE AND GIFT TAXES

Gift Tax

- Nonresident aliens are taxed on gifts of tangible (but not intangible) property located in the United States
  - Gift of U.S. real property is subject to gift tax
  - Gift of stock (whether domestic or foreign corporation) is ***not*** subject to tax
  - Gift of partnership interest probably ***not*** subject to tax
  - Points to note:
    - No step-up in basis on *inter vivos* gift
    - No unified credit
    - Substance over form risk. For example:

      Donee or trust is funded with cash and purchases real property from grantor – e.g., *Davies v. Commissioner*, 40 T.C. 525 (1963)

      Foreign owner contributes property to partnership and then makes gift of partnership interest

Estate Tax

- Estate of nonresident alien is subject to estate tax on property located in the United States. Includes:
  - U.S. real property and tangible property located on it
  - Stock in U.S. corporation (publicly traded or not)
  - But not stock in foreign corporation
  - Top rate (2013) 40%; unified credit equivalent to $60,000 exemption (unchanged for decades)
- Uncertain treatment of partnership interests
  - IRS position: Interest is located in the U.S. if partnership is engaged in U.S. trade or business. What if:
    - Partnership not ETB but decedent elected under §871(d)?
    - Partnership owns only residence for NRA’s personal use?
  - Other theories: Place of organization or partner domicile

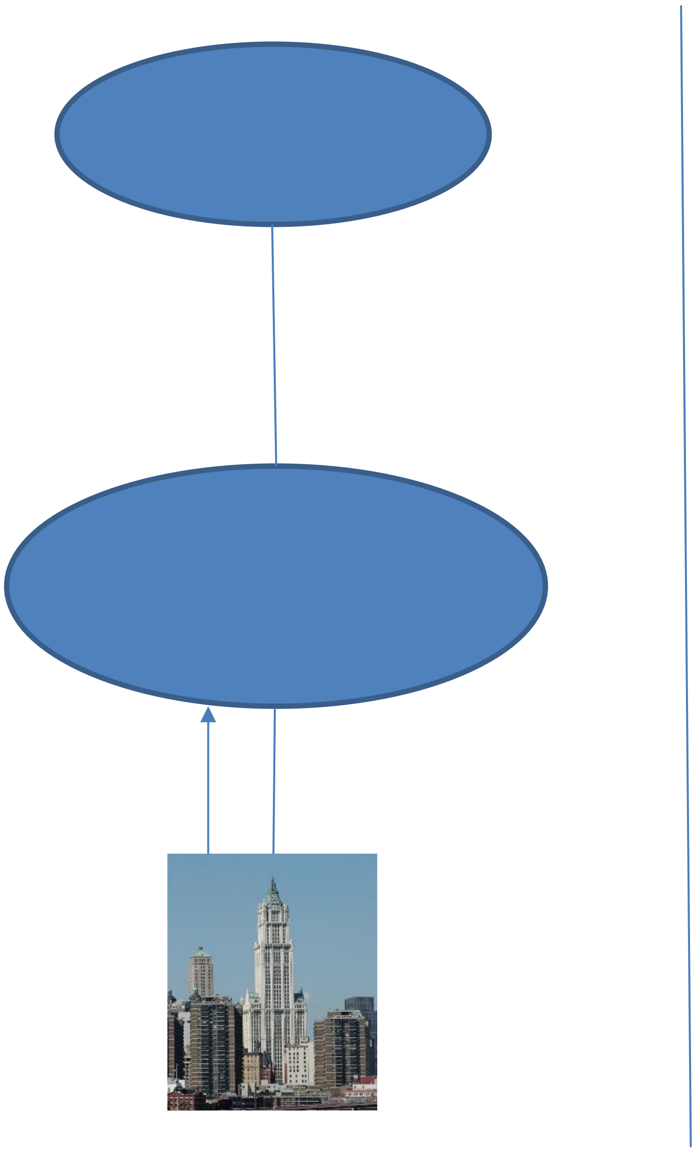
Planning Considerations and Alternative Structures – Real Estate

Before Planning Begins

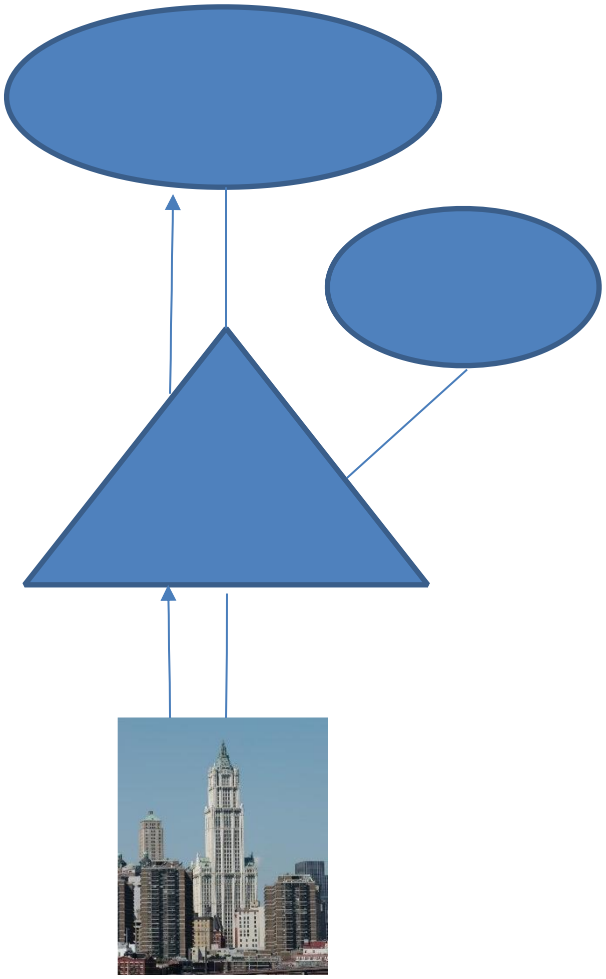
- Understand investor characteristics - type, location
- Ascertain investment characteristics and objectives:
  - Use – personal, development, investment
  - Types of income generated from real estate: Rent, interest,

Structure 1: Direct Investment by a Foreign Individual

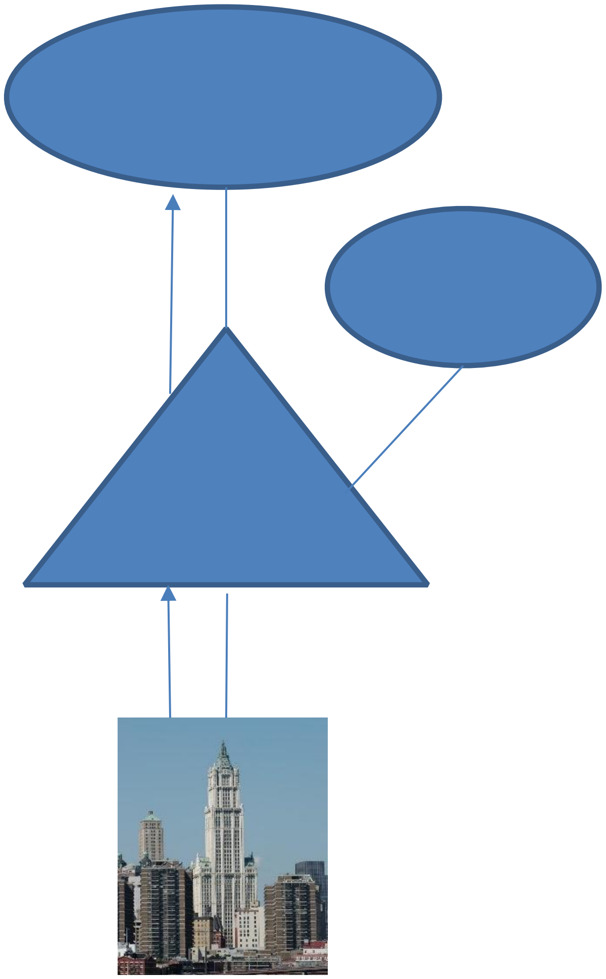
Structure 2: Investment by Foreign Individual Through Disregarded Entity



Structure 3: Investment by Foreign Individual Through Domestic Partnership

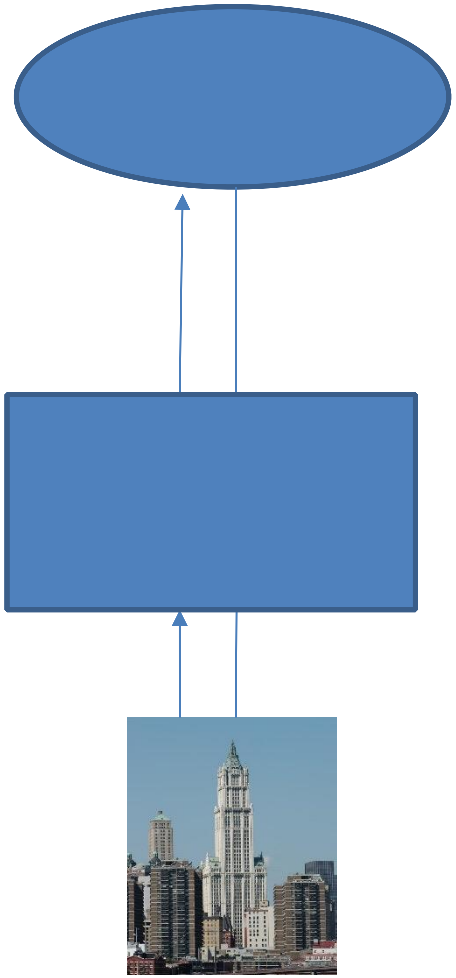


Structure 4: Investment by Foreign Individual Through Foreign Partnership

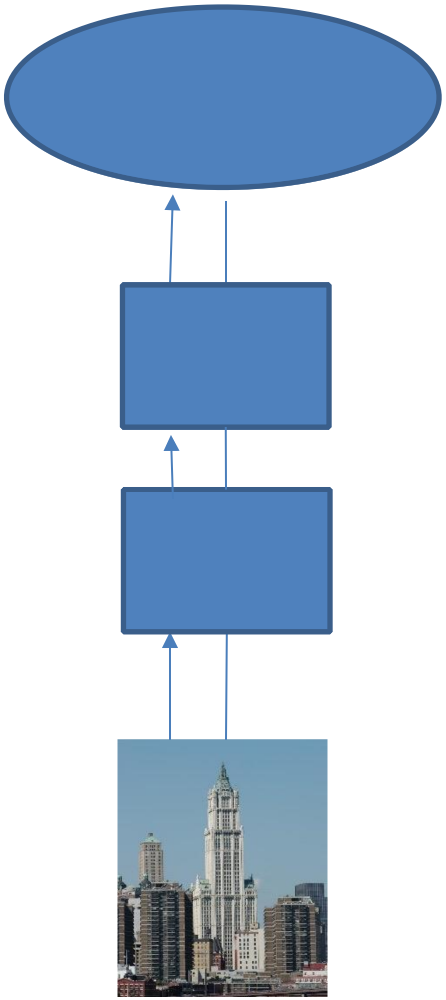


Structure 5: Investment by Foreign Individual Through Foreign Corporation

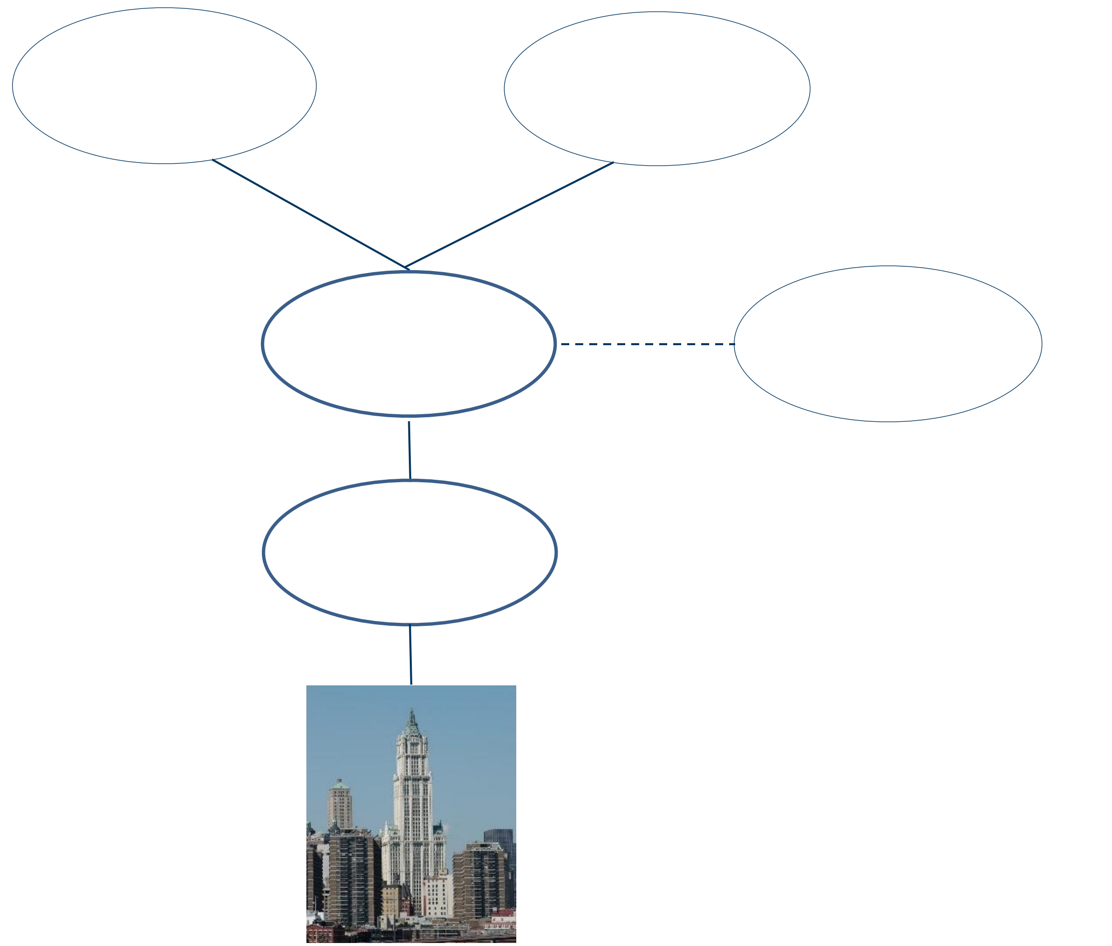
Structure 6: Investment by Foreign Individual Through Domestic Corporation



Structure 7: Investment by Foreign Individual Through Foreign and Domestic Corporation

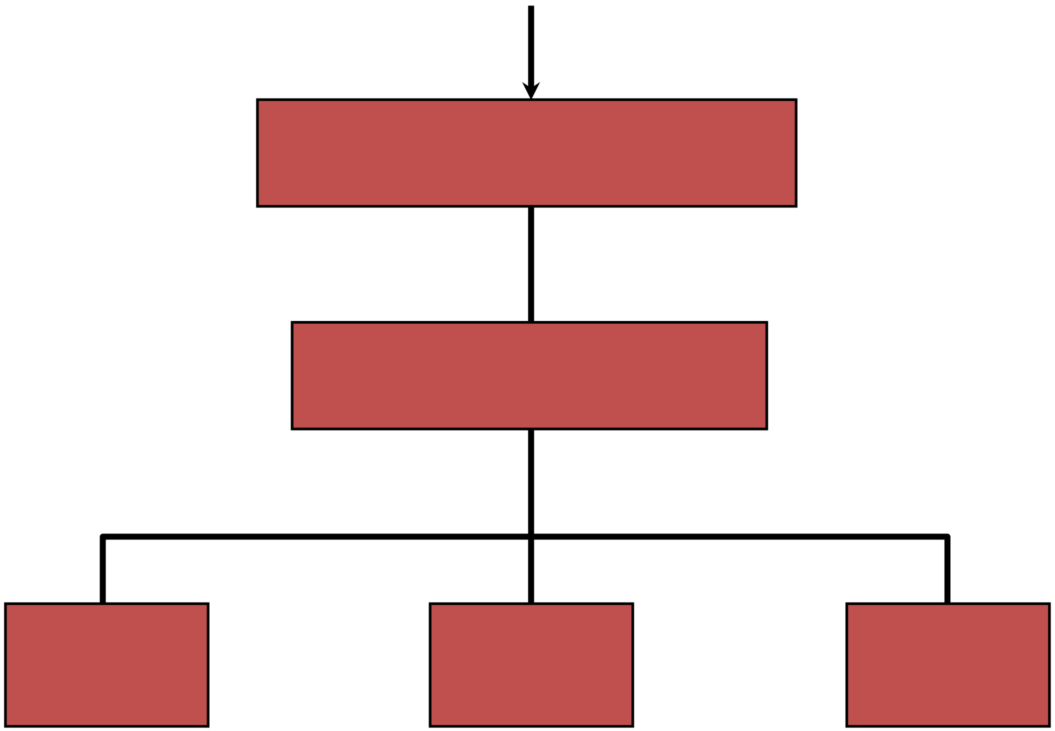


Structure 8: Use of Trust

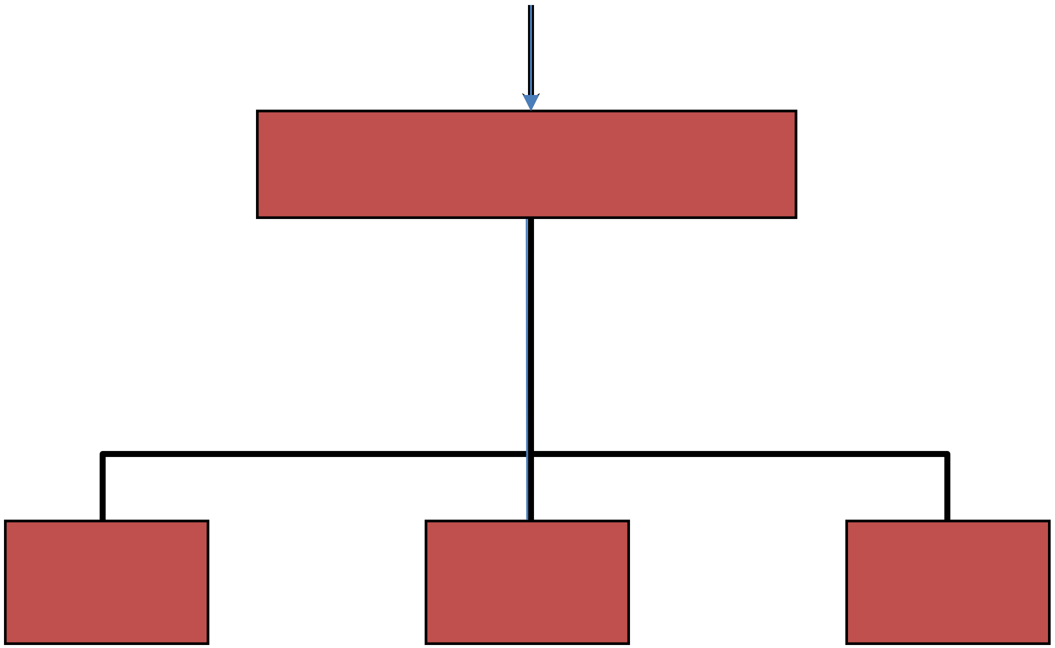


A Few More Structures

Structure 9: Multiple Properties - Consolidation Priority



Structure 10: Multiple Properties — Distribution of Sale Proceeds Priority



Use of Debt

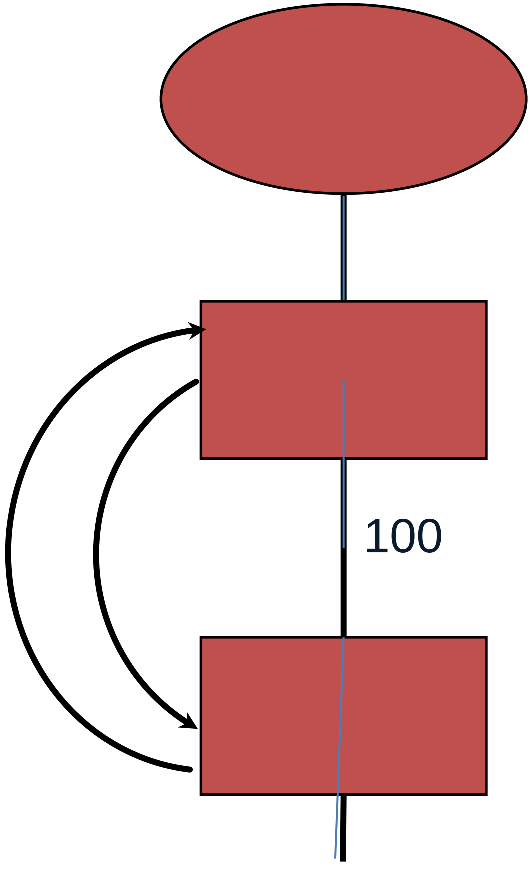
Using Debt to Reduce Inefficiency of Corporate Structure

- Interest deduction reduces corporate tax base
  - Earnings-stripping and other limitations apply
- Repayment of principal allows repatriation to shareholder on tax-free basis
- If possible, desirable to avoid or reduce WHT
  - Treaty
  - Portfolio interest exemption
- Need to ensure debt respected for tax purposes, e.g.,
  - Documentation
  - Interest rate cannot be excessive
  - Cannot be thinly capitalized
  - Reasonable term

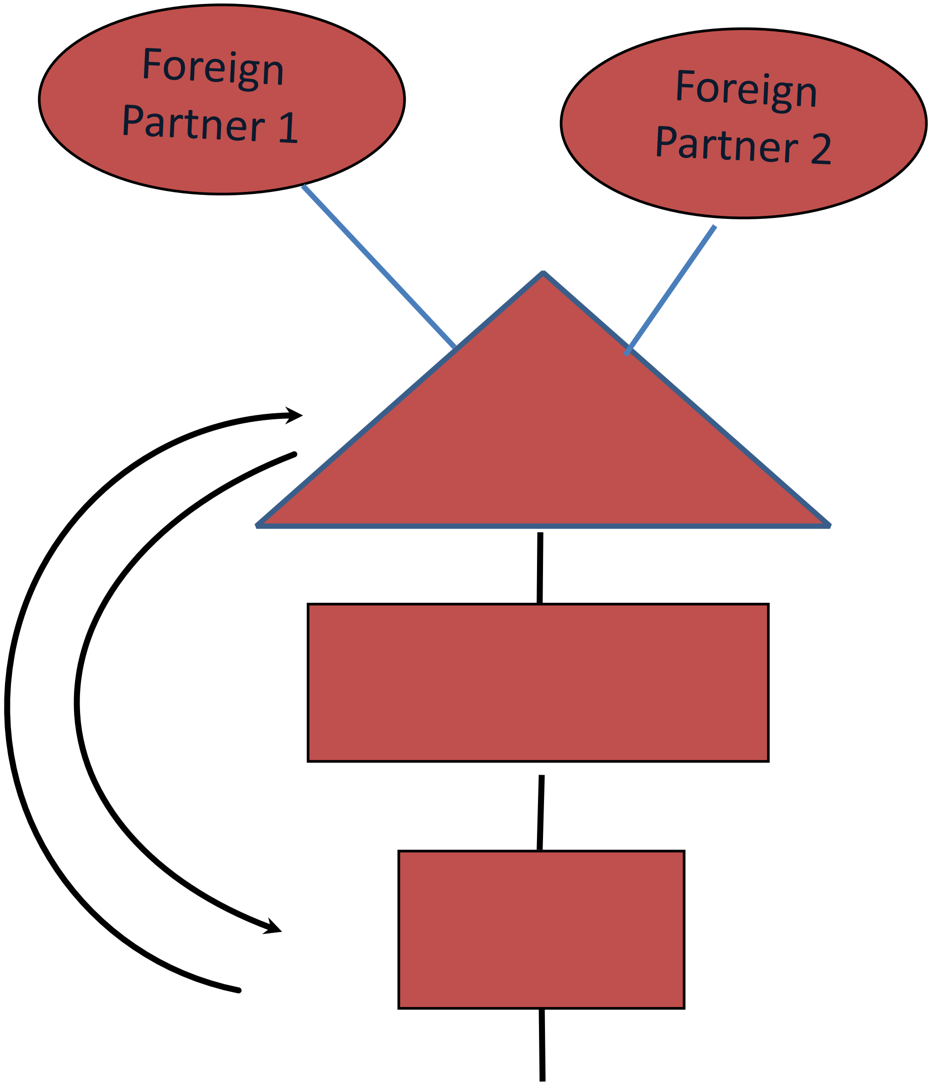
Portfolio Interest Exemption (for non-ECI)

- Interest must be fixed
  - No kicker allowed
- Lender may not be "10% shareholder" of borrower
  - For corporate borrower, based on voting power
  - For partnership borrower, based on capital or profits interests
- Lender may not be a bank making loan in ordinary course or a CFC related to borrower
- Must certify foreign status

Structure 11: Treaty Loan Structure

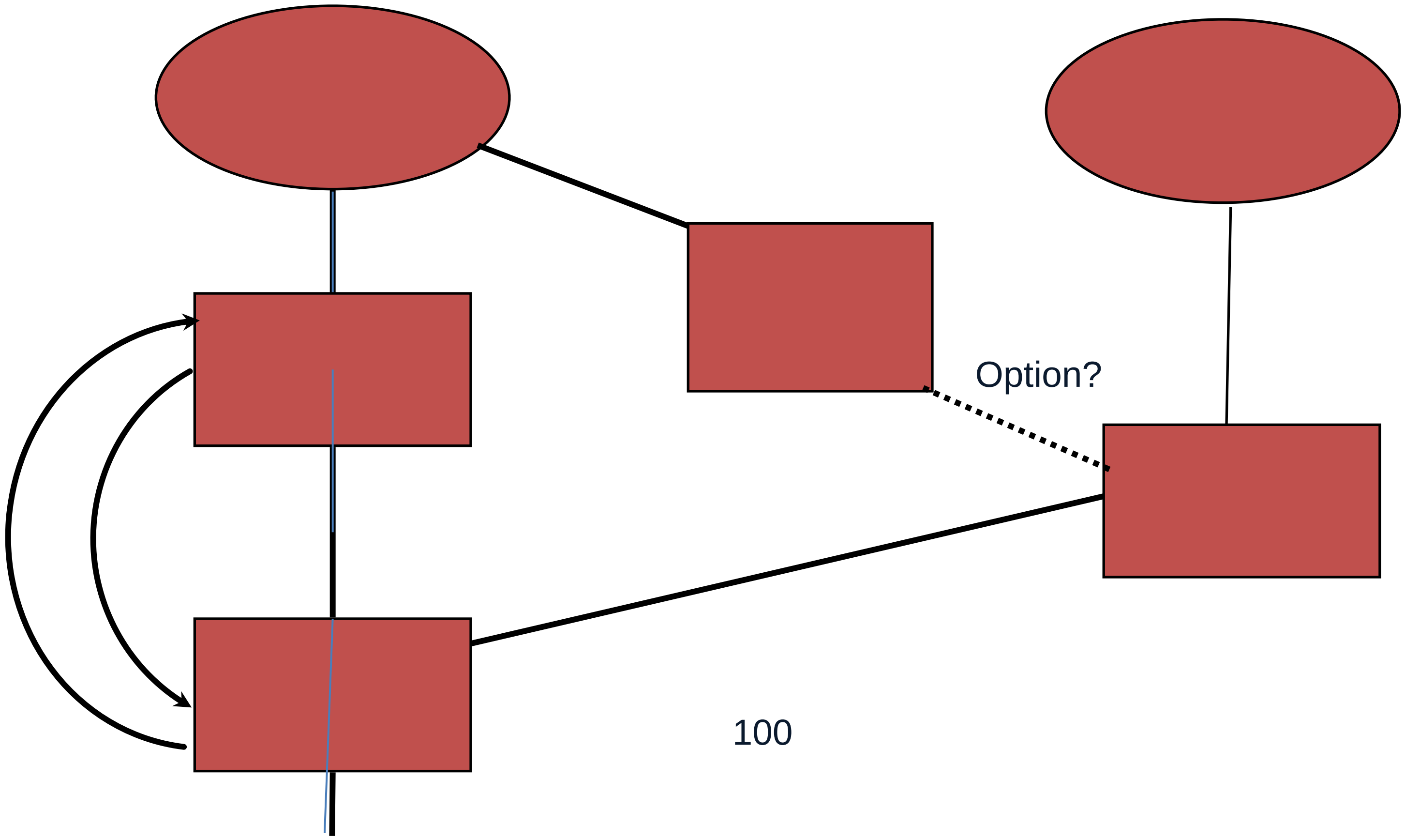


Structure 12: Portfolio Interest Partnership Lender Structure For Investor Group

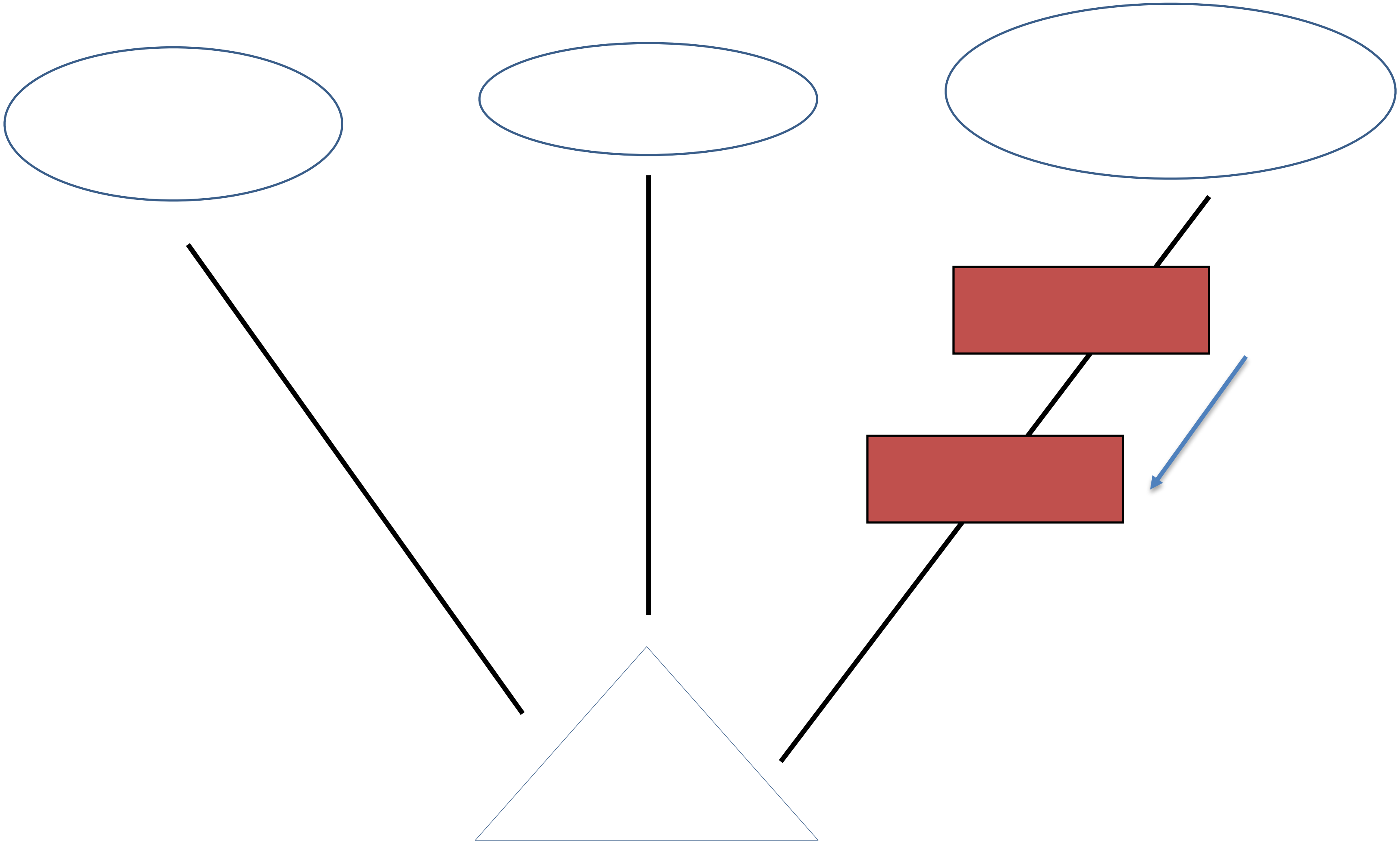


All foreign partners have less than 10% of FP.

Structure 13: Portfolio Interest Split Vote/Value Structure



Structure 14: Partnership to Accommodate Multiple Investors With Disparate Tax Objectives



Shared Appreciation Mortgage

Sample SAM

- Loan $1,000,000 to purchaser of property for $1,500,000 purchase price.
- Lender receives 4% interest per year plus 20% of appreciation after five years (or gain on earlier sale).
- Lender has some aspects of a real estate investment.
- Critical that SAM be respected as debt for tax purposes.

REIT Structures

REIT Requirements

- 100 Shareholders
  - Easily dealt with
- Five or fewer test
  - Prevents individual or family (or even a handful of families) from forming private REIT
- REIT Election
- Restrictions as to nature of income and assets
  - In extremely general terms, the intention is for REITs to be passive vehicles
  - Active operations can potentially be placed into taxable REIT subsidiaries

Advantages of REIT Status

- REITs effectively pay no corporate tax
  - Dividend paid deduction

- Favorable for foreign investors, who generally pay federal but may not pay state local tax on REIT dividends

- Tax-free sale of domestically controlled REIT stock

- Tax-free sale of stock of regularly traded REIT (or non-REIT) stock if the foreign investors has not owned more than 5% at any time during a 5-year look-back period.

Taxation of REIT Dividends

- Ordinary REIT Dividend
  - Same treatment as non-REIT dividends, i.e., gross withholding at 30% or lower treaty rate
  - Only difference is that treaty benefits for REIT dividends are typically less favorable, in view of the fact that corporate tax has not been imposed
- "FIRPTA" Dividends
  - When a REIT sells USRPI at a gain and makes distributions to its shareholders that are attributable to such gain, those "FIRPTA" dividends are treated as USRPI gains under section 897(h)(1).
    - Treaty benefits do not apply.
    - Also subject to BPT, in the case of corporate foreign investors.
    - The REIT must withhold on the distribution.
    - Section 897(h) n/a if the REIT stock is regularly traded and the foreign investor did not own more than 5% at any time during a 1-year look-back period.

      In such case, the ordinary REIT dividend rules apply.
- Section 892 Discussed Below

Structure15: Domestically Controlled REIT

Foreign Sovereign Exemption (section 892)

Section 892

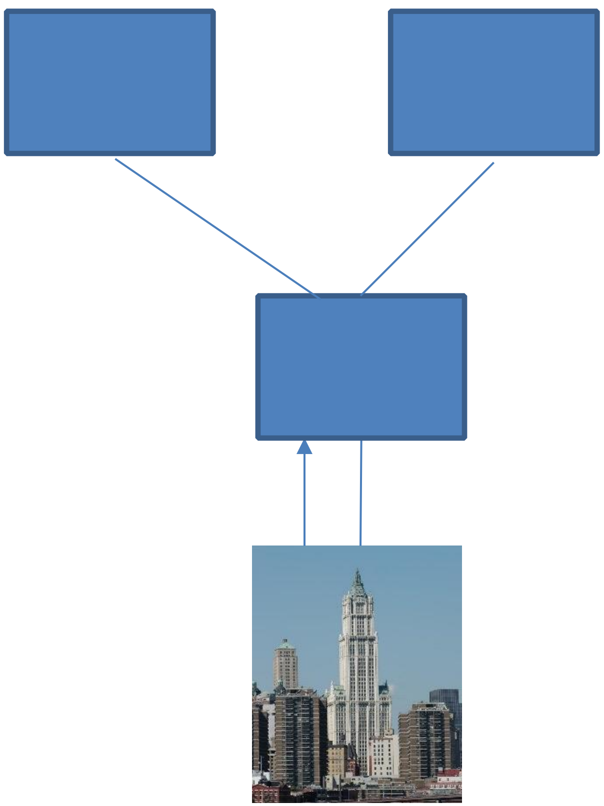
- Excludes from gross income the income of a foreign government from, among other things, investments in the United States in stocks, bonds, or other US securities.
  - Includes both integral parts and controlled (wholly owned) entities of the foreign sovereign.

- Does not apply to income from commercial activities.

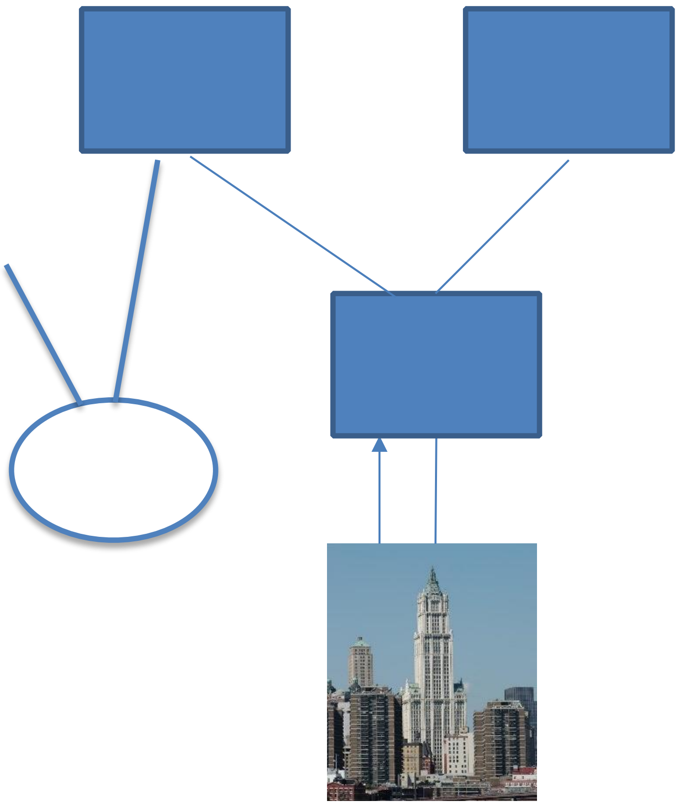
- Overrides FIRPTA with respect to stock of a US corporation that is (or, during the lookback period, was) a USRPHC other than a controlled commercial entity.

- Does not apply to
  - income from commercial activities
  - income earned by or from controlled commercial entities

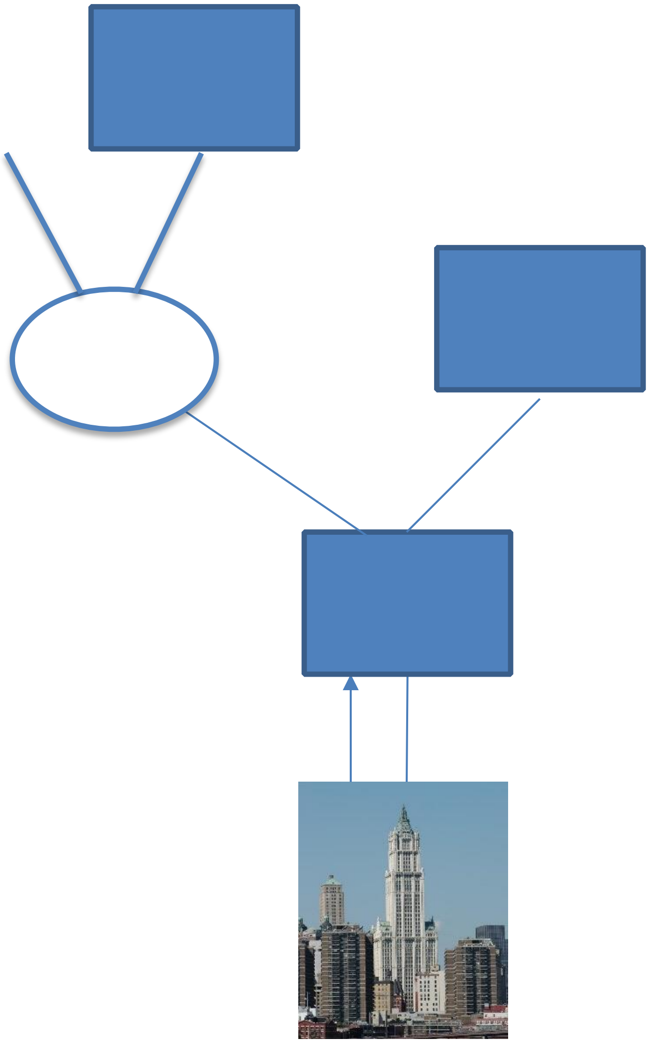
Structure 16: Foreign Controlled REIT



Structure 17: Controlled Commercial Entity Problem

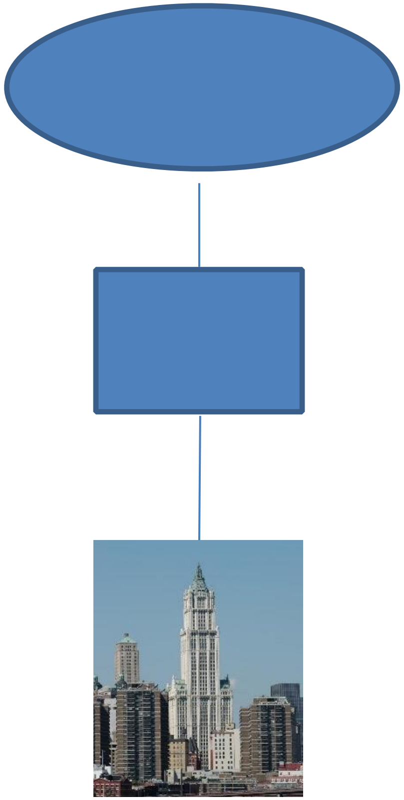


Structure 18: Partnership Issues



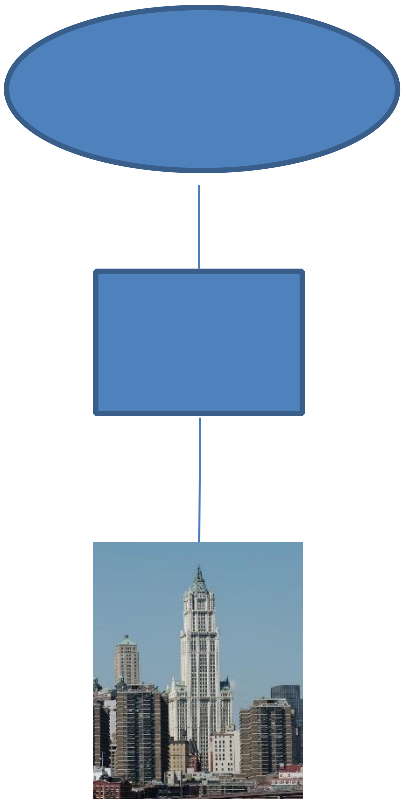
Unwinding Corporate Structures

Structure 19: Acquisition of Foreign Corporation with USRPI — Now What? (Part I)



extremely

Structure 19: Acquisition of Foreign Corporation with USRPI — Now What? (Part II)

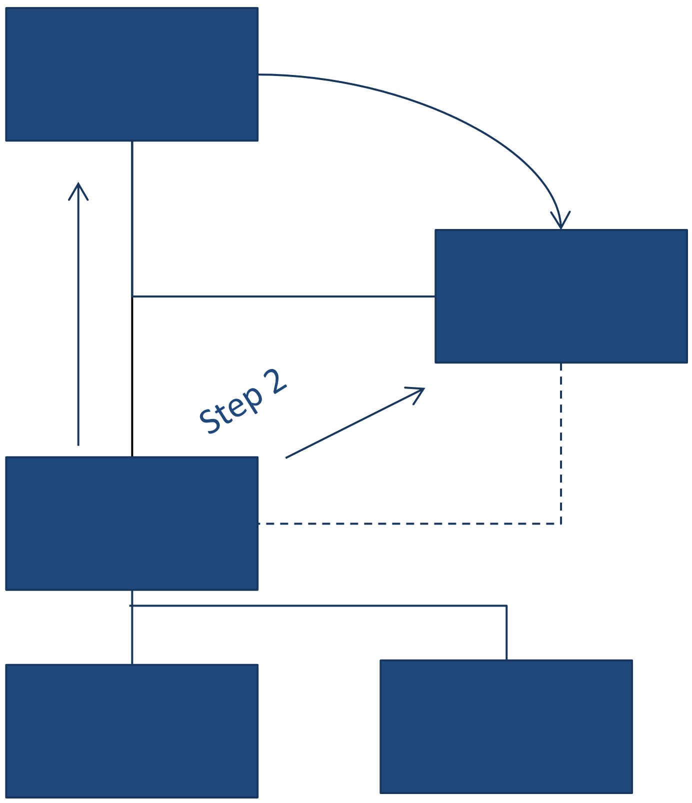


Repatriation Strategies

Repatriation Strategies - Brazil

Boot Within Gain Exception

Transaction Steps

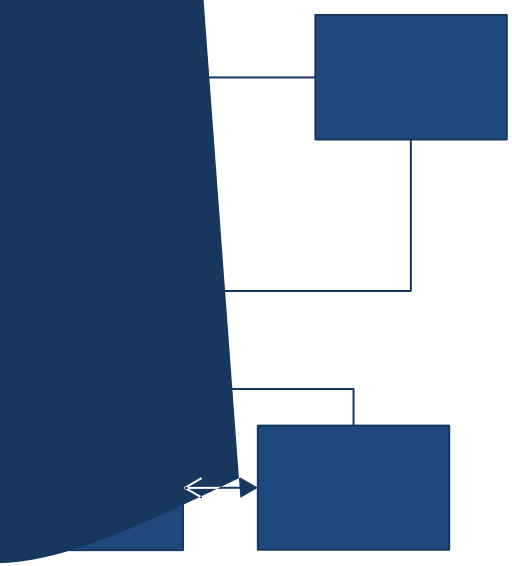


Transaction Steps

- Step 1: Brazil Parent transfers 25% of the shares of Brazil Sub 1 to Brazil Sub 2.
- Step 2: Brazil Sub 1 makes a tax election to liquidate for U.S. Federal tax purposes, distributing its assets to its shareholders.

[redacted]in Gain Exception (cont.)

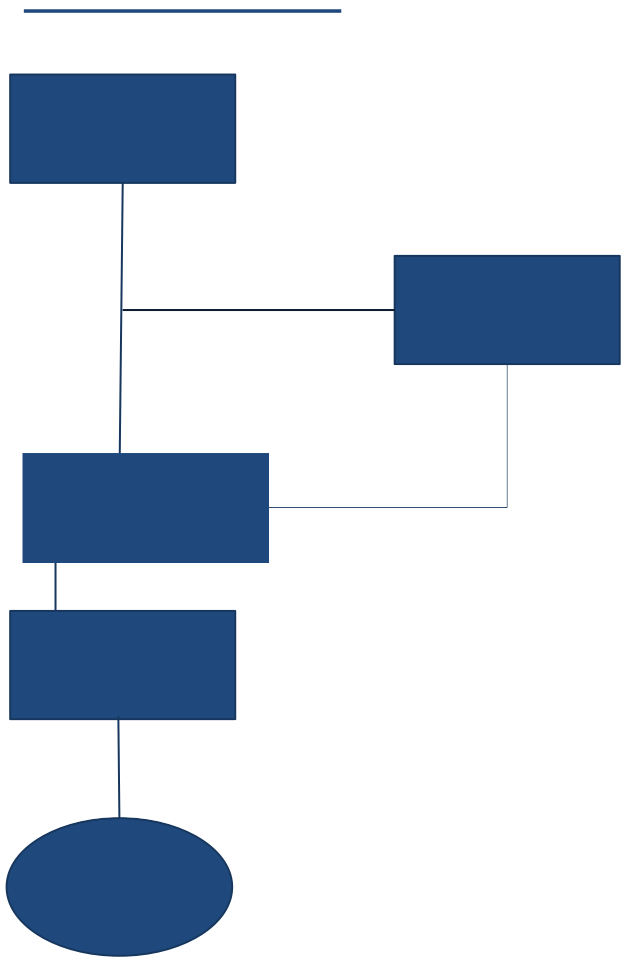
[redacted]Steps (Cont'd)



Transaction Steps (Cont'd)

- Step 3: US Group 1 merges with US Group 2 with Brazil Sub 1 receiving cash in the merger.
  - The direction of the merger could be reversed depending on various considerations.
  - A merger into a disregarded entity of the US acquiring company may also be possible.

Boot Within Gain Exception (cont.)



U.S. Federal Income Tax Considerations

- If the transaction is respected, step 1 and 2 will step up the basis in the stock of US Group 2. See Granite Trust and Sections 331 and 336.
- Step 3 is intended to be a D reorganization subject to the boot within gain limitation of Section 356.

Brazil Tax Considerations

- Step 1 – Tax neutral, provided it is implemented at book value
- Step 3 – From a Brazilian tax perspective, deemed as a share deal
  - Risk of capital gain taxation in case implemented at fair market value
  - Interposition of a Hold Co (e.g. in Austria or Spain) could be an alternative
  - If paid through Spanish holding company (ETVE), dividends can be received tax-free in Brazil under Spain-Brazil income tax treaty.

Planning with Treaties with Derivative Benefit Provisions

Derivative Benefits Provisions – In General

- Many treaties concluded with the United States that have LOB provisions contain a “derivative benefits” clause in such provision.
- Under such provision, a company that qualifies as a “resident” for treaty purposes, but fails to qualify under the LOB provision because of ownership by third country residents, may still qualify for treaty benefits if the third country owners are “equivalent beneficiaries.”

Derivative Benefits – In General

- To qualify as an equivalent beneficiary, the following factors typically must be satisfied:
  - (i) there is a tax treaty between the equivalent beneficiary's country of residence and the United States,
  - (ii) the equivalent beneficiary would be entitled to benefits under that treaty if it invested directly in the United States, instead of through the treaty company, and
  - (iii) in the case of interest, dividends, and royalties, the treaty between the United States and the equivalent beneficiary's country of residence must provide a withholding rate that is "as least as low" as the rate available under the treaty claimed.

Derivative Benefits – In General

- In addition, the equivalent beneficiary typically must be resident in:
  - A European Union (EU) jurisdiction,
  - A European Economic Area (EEA) jurisdiction,
  - A jurisdiction that is a party to the North American Free Trade Agreement (NAFTA),
  - Switzerland.
  - Australia (in the case of Malta treaty)

Derivative Benefits – In General

- Example: Assume FCo, a French company, wholly owns a U.K. company (UKCo), which in turn wholly owns a U.S. company (USCo). With respect to dividends, the U.S.-U.K. treaty has (i) no withholding for 80-percent-or greater corporate owners, (ii) 5 percent withholding for 10-percent-or-greater corporate owners, and (iii) 15 percent in all other cases. Under the U.S.-French treaty, the lowest withholding rate on dividends is 5 percent. Despite the fact that U.S. has treaty with France (a member of the EU), and FCo would be entitled to treaty benefits under the U.S.-France treaty, FCo is not equivalent beneficiary because the withholding rate on dividends under U.S.-France treaty (5 percent) is not as low as lowest withholding rate under U.S-U.K. treaty. Thus, dividends paid from USCo to UKCo not eligible for 0 percent rate. *Query* whether rate is 30 percent or 5 percent?

Current List of Treaties that have Derivative Benefits Provisions

- Belgium – applies to EU, EEA, NAFTA, and Switzerland
- Canada – applies to any jurisdiction that has treaty with the U.S.
- Denmark - applies to EU and EEA, and parties to NAFTA
- Finland - applies to EU and EEA, and parties to NAFTA
- Germany - applies to EU and EEA, and parties to NAFTA
- Iceland - applies to UE and EEA, and parties to NAFTA
- Ireland - applies to EU and EEA, and parties to NAFTA
- Jamaica – applies to any jurisdiction that has treaty with the U.S.
- Luxembourg – applies to members of EU and parties to NAFTA
- Malta - applies to EU and EEU, parties to NAFTA and Australia
- Mexico – applies to parties to NAFTA
- Netherlands - applies to EU and EEA, and parties to NAFTA
- Sweden - applies to EU, EEA, parties to NAFTA, and Switzerland
- Switzerland - applies to EU and EEA, and parties to NAFTA
- United Kingdom - applies to EU and EEA, and parties to NAFTA

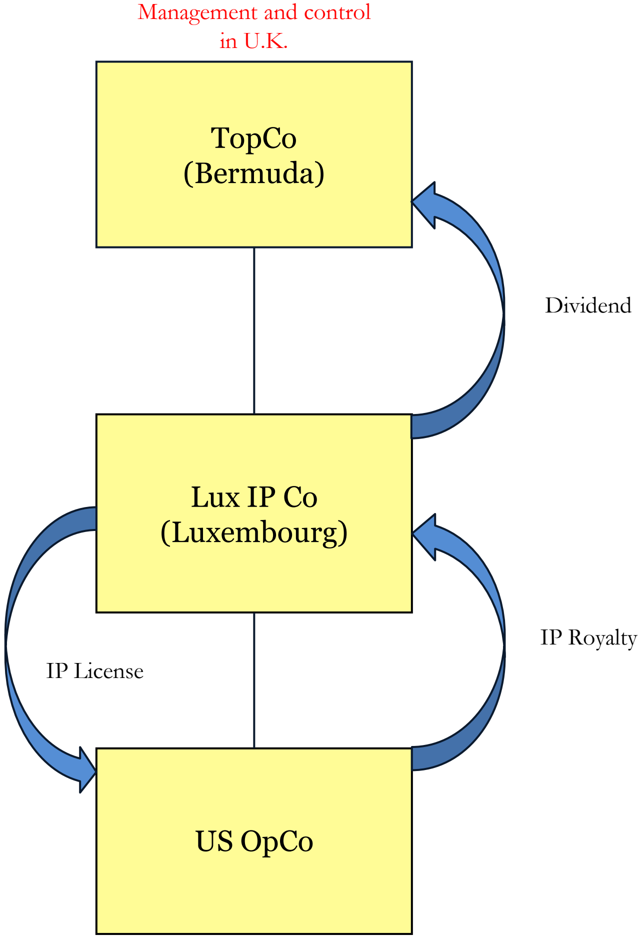
Planning Opportunities – Local Law Shopping

- One foreign jurisdiction may have more favorable local tax benefits than other jurisdiction, including:
  - Lower corporate income tax rate
  - Participation exemption on dividends and capital gains
  - No withholding on interest, dividends, or royalties
  - No thin capitalization rules
  - No stamp or capital duties
  - Better treaty network
  - No transfer pricing rules
  - Tax consolidation or group relief

Planning Opportunities – Local Law Shopping

- Example: Residents of France wish to lend money to the United States to finance the acquisition of U.S. real property that will be owned by related parties. Instead of investing through French corporation, which has a 33.3 percent corporate income tax rate, French taxpayers invest through Swiss corporation, which has an 8.5 percent effective corporate income tax rate, no withholding taxes on interest and royalties, and very favorable participation exemption for dividends and capital gains. Both U.S.-France and U.S.-Swiss treaties provide for 0 percent withholding on interest paid from U.S. sources. French residents would qualify as "equivalent beneficiaries" under U.S.-Swiss treaty, and therefore, have the ability to shop for more favorable local tax benefits.

Licensing of IP into U.S. through Luxembourg



- Restructuring
  - Management and control of TopCo is moved to the U.K. so that TopCo can qualify as a U.K. resident for purposes of U.S.-Luxembourg and U.S.-U.K. income tax treaties.
  - US OpCo pays royalties to Lux IP Co
  - Lux IP Co pays dividends to TopCo
- Tax treatment
  - Royalties paid by US OpCo to Lux IP Co:
    - Exempt from U.S. withholding tax under U.S.-Luxembourg Treaty
    - Subject to an effective tax rate of 5.84% in Luxembourg
  - Dividends paid by Lux IP Co to TopCo:
    - Not subject to withholding tax in Luxembourg
    - Exempt from tax in Bermuda and the U.K.
  - **Overall effective tax rate = 5.84%**

License of IP and Royalty Free License from Ireland

- Restructuring
  - Management and control of TopCo moved to the U.K.
  - Lux IP Co is formed to hold US OpCo
  - Irish Co licenses IP to Lux IP Co on a royalty-free basis
  - Lux IP Co licenses the IP to US OpCo in exchange for royalty payment
  - Lux IP Co pays dividends to TopCo
- Tax treatment
  - Royalty payments
    - No transfer pricing rules on passive income in Ireland so no taxable income because no actual royalty payment
    - Royalty payment from US OpCo to Lux IP Co exempt from U.S. withholding tax under U.S.-Luxembourg Treaty
    - Minimal tax in Luxembourg due to deemed royalty deduction
      - Leaving a spread of approximately 5% of income
      - Spread taxed at regular corporate income tax rate of 28.8% in Luxembourg
  - Dividends paid by Lux IP Co to TopCo
    - Not subject to withholding tax in Luxembourg
    - Exempt from tax in Bermuda and the U.K.
  - **Overall effective tax rate = less than 1%**

Tax Planning with Treaties Without LOB Provisions

- Current list of treaties without LOB provisions:
  - Greece
  - Romania
  - Pakistan
  - The Philippines
  - Egypt
  - Morocco
  - Trinidad and Tobago
  - Korea
  - Poland - New treaty signed but not effective yet
  - Hungary – New treaty signed but not effective yet.
  - Norway – Treaty has been re-negotiated but not signed or released yet.

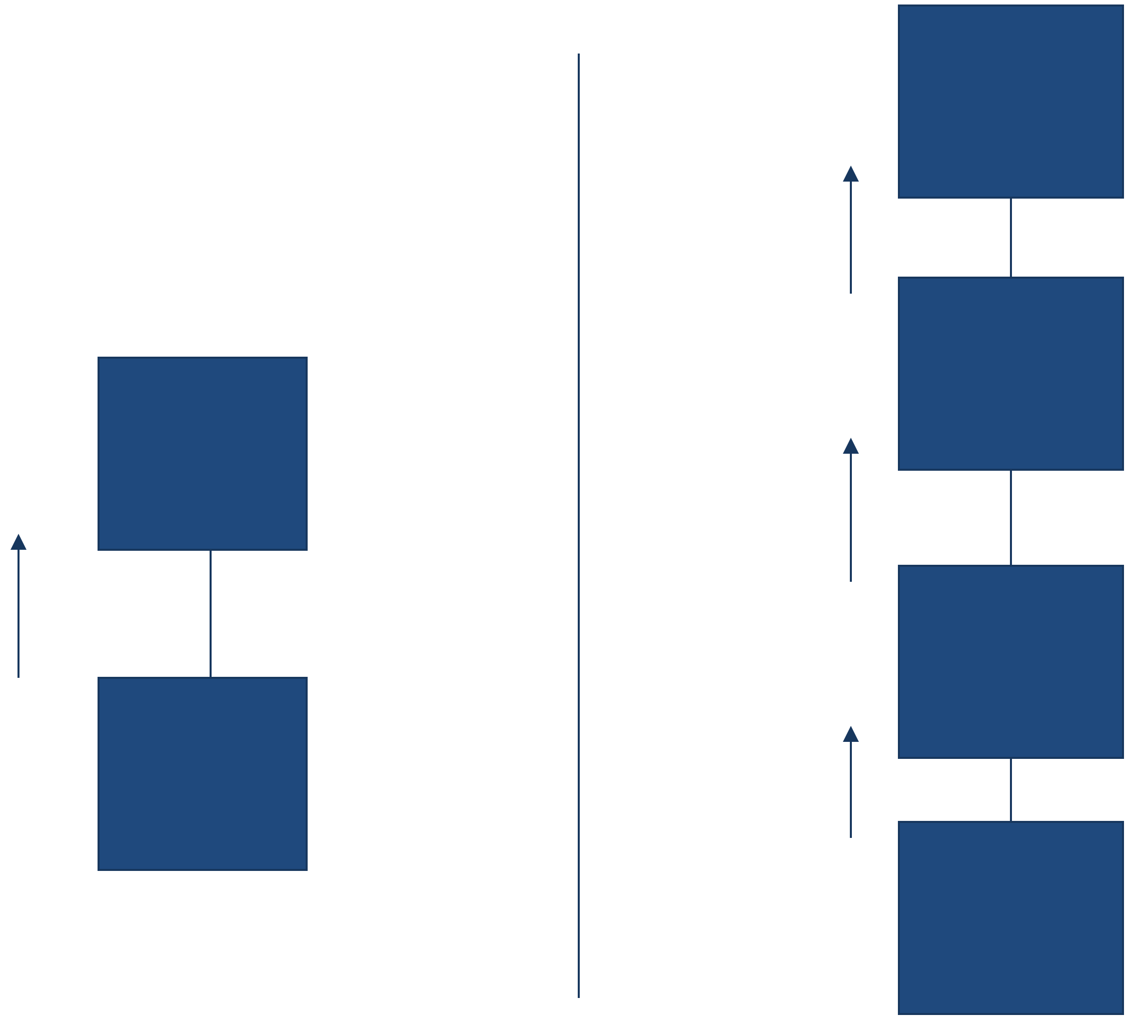
Planning with Treaties Without LOB Provisions

- Repatriation of Profits from the U.S. to Non-Treaty Jurisdictions
  - Dividends paid by U.S. corporations to foreign non-treaty shareholders subject to 30 percent withholding tax in the United States.
  - Possible to reduce dividend withholding tax from 30 percent to 5 percent by insertion of treaty company that (i) has no LOB provision and (ii) exempts U.S.-source dividend from corporate income tax, either as a result of participation exemption or foreign tax credit.

Tax Planning with Treaties Without LOB Provisions

- An example of a treaty jurisdiction:
  - Poland
    - U.S-Poland treaty has no LOB provision and has 5 percent withholding tax on dividends paid by U.S. corporations that are owned by Polish corporations that own at least 10 percent of the voting stock of the U.S. corporation.
    - Poland has foreign tax credit that allows U.S. corporate taxes to be credited against Polish corporate taxes (currently 19% tax rate in Poland), so long as Polish company owns 75% of U.S. company,
    - Poland does not impose withholding taxes on dividends paid to EU jurisdictions

Tax Planning with Treaties Without LOB Provisions



Contact Information

- Alan I. Appel, New York Law School
  - Email: alan.appel@nyls.edu
- Michael Hirschfeld, Dechert LLP
  - Email: michael.hirschfeld@dechert.com
- Philip R. Hirschfeld, Ruchelman P.L.L.C.
  - Email: hirschfeld@ruchelaw.com
- Jeffrey L. Rubinger, Bilzin Sumberg
  - Email: jrubinger@bilzin.com