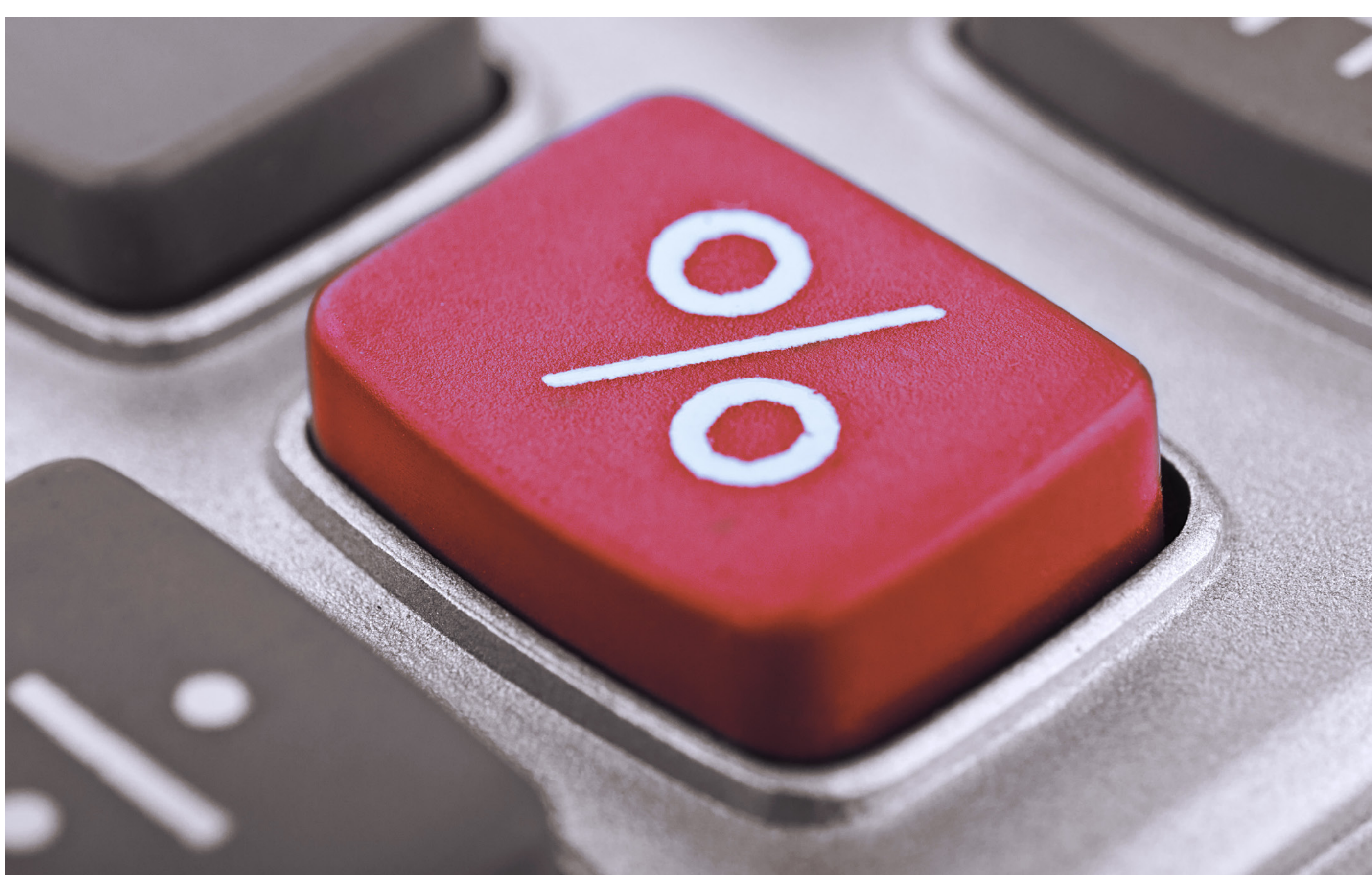

TAX

Beate Erwin, Tax Attorney at Ruchelman P.L.L.C.

Within business, tax is always a contentious issue. It is a significant consideration for all businesses, and one which needs considerable attention to remain compliant and trouble-free. To find out more, *Lawyer Monthly* speaks to Beate Erwin, tax attorney at Ruchelman P.L.L.C., a New York based boutique tax law firm with an office in Toronto, Canada, of 11 tax attorneys and one corporate attorney.

Your practice is concentrated on taxation with a specific focus on inbound investment to the US? What aspects of the US taxation system attract foreign investors to the market?

Even though the economy has still not fully recovered, the United States have experienced a lot of improvement overall. In the light of such recovery, our practice has seen a high interest by foreign investors in U.S. real estate as well as in expanding their businesses into the United States. That foreign investors are willing to enter the U.S. market is, however, definitely more driven by the expectations of return on capital than the U.S. tax environment. While there are a few incentives such as the portfolio exemption for certain interest payments, foreign investors are currently confronted with, inter alia, the following: The United States' tax system comprises one of the highest corporate income tax rates of the world of up to 35% (not including state tax), strict rules on the limitation on deductibility of interest paid by foreign owned U.S. corporations to affiliates (so-called earnings stripping rule), comprehensive filing and reporting requirements as well as specific rules under the Foreign Investment in Real Property Tax Act (F.I.R.P.T.A.)(see below).

How complex can these tax aspects become? What challenges do they raise?

For real estate deals in the United States, F.I.R.P.T.A. dictates how gains are taxed from the disposition of United States Real Property Interests ("U.S.R.P.I.'s"). The law has a fairly extensive definition of U.S. real property for this purpose. Most significantly, the law provides for a withholding mechanism in most cases. In addition, the United States tax system offers tax neutral reorganizations which, however, face a series of restrictions if such a transaction shall include U.S. real estate. Careful structuring is advised if real estate investments are pursued by foreign investors which needs to be tailored to the specific circumstances at issue including possible exit scenarios.

With respect to expanding into the United States market, the choice of legal form goes hand in hand with determining the tax implications. For instance, additional tax on foreign corporations doing trade or business in the United States via branches may trigger branch profits tax and branch interest tax. The issue of start-up losses and expected break-even is one of the factors in choosing the right form. For subsidiaries which should in turn hold foreign investments anti-deferral rules under Subpart F, and Passive Foreign Investment Companies rules (P.F.I.C.) may apply. Furthermore, a number of reporting obligations on the U.S. subsidiary's foreign subsidiaries including information on intercompany transactions, balance sheet and profit and loss account details etc. exist. If the U.S. subsidiary has foreign accounts, these must be reported on separate forms (F.B.A.R. reporting). Non-compliance with such reporting requirements ensues hefty penalties ranging from USD 10,000 up to 50% of the unreported foreign bank account balances.

Furthermore, the foreign investor may be confronted with U.S. withholding tax obligations as well as furnishing certificates on his eligibility to income tax treaty benefits (Forms W-8). The latter has expanded from a two page form to an eight page one including the determination of its status under the Foreign Account Tax Compliance Act (F.A.T.C.A.). In brief, this would include an analysis whether the foreign investor would be deemed an active or passive financial institution which is not always a clear cut determination, especially in the context of foreign holding companies rendering certain treasury services to the group. Depending on the outcome of such analysis, more reporting requirements under F.A.T.C.A. would need to be met. Our firm has a strong team dealing with such kinds of F.A.T.C.A. issues.

What makes the US unique in its tax laws?

I already addressed the anti-deferral rules under Subpart F. Apart from this, coming from a European country, the other unique feature of the U.S. tax law is the principle of subjecting its citizens and green card holders to U.S. tax based on their worldwide income – irrespective of whether or not they are resident in the United States. The issues arising from such a system are manifold but most outstanding are filing and reporting requirements such persons may not be aware of, especially if they moved to another country at an early age. Or have become aware of only recently in the wake of the F.A.T.C.A. rules on reporting of foreign bank accounts held by U.S. persons and foreign banks reaching out to them to confirm their status and compliance with such reporting obligations. It should be noted that the I.R.S. has now two main programs in place for such U.S. persons to come into compliance, the Offshore Voluntary Disclosure Program as well as the Streamlined Offshore Program. Penalties under such programs are significantly reduced ranging from 27.5%, to 5% and 0%, depending on whether non-compliance was wilful or non-wilful and the taxpayer is resident in the United States or abroad while coming into compliance. We have a team dedicated to such cases.

Finally, in a treaty context, another unique feature so far are various tests to be met in addition to residency in order to be eligible to income tax treaty benefits (so-called limitation on benefits (L.O.B.) clauses), included in most of the treaties signed by the United States, except a few old ones that have not been revised yet. This may change in the not too distant future with the O.E.C.D. draft of similar clauses, as part of the O.E.C.D.'s B.E.P.S. initiative, to be included in its Model Convention. In this respect, our experience with the interpretation of the L.O.B. clauses may serve as guidance for O.E.C.D. countries once implemented into the M.C.

How satisfied are you with the tax system here at the moment?

The tax system in its current status leaves much to be desired. In addition to the issue of taxing persons based on their citizenship/green card status, the corporate income tax rate is one of the highest throughout the world. Instead of attacking U.S. companies seeking a way out via inversions a reduction of the corporate income tax rate combined with incentives such as tax favourable treatment of repatriation of funds may attract more money to be invested in the United States and keep businesses in this country.

Is there anything else you would like to add?

To end on a positive note, there have also been developments in the United States that were in favour of taxpayers, in particular, multinationals with U.S. operations and cost sharing agreements in place. In its Altera decision[1] issued on July 27, 2015, the U.S. Tax Court struck down 2003 cost-sharing regulations that require the sharing of stock-based compensation (S.B.C.) under a cost sharing agreement (C.S.A.) with a party under common control for purposes of transfer pricing rules. The court held that the regulations lack "a basis in fact" and are invalid as a matter of law. Because independent parties and the Federal government do not share S.B.C. costs, the I.R.S. found itself in a deep logic hole when arguing its position for partial summary judgment in Altera. While not final, this decision was not only an important first win for the taxpayer but is also considered to result in an uphill battle for the I.R.S., should it appeal.

More details on this decision can be found in our Insights issue Vol. 2 No. 7 (see also http://publications.ruchelaw.com/news/2015-08/Vol02No07-03-Altera.pdf). **LM**

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[1] Altera Corp. v. Comm'r., 145 T.C. No. 3 (July 27, 2015) ("Altera"). Note that on December 18, 2015 Altera challenged the I.R.S. again, on the same grounds, but involving later years and subsequent versions of the cost sharing regulations (Altera Corp. v. Comm'r., T.C. No. 31538-15).