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INSIGHTS

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EDITORS' NOTE

In this month's edition of *Insights*, we focus on the following topics:

- **Inbound Investment In German Real Estate.** The lead article provides tax planning for investments in German real estate. It is authored by Dr. Petra Eckl, a partner at GSK Stockmann + Kollegen in Frankfurt, Germany. Major savings in trade and income taxes can be achieved.

- **Tax 101: Updates to Procedures Relating to Withholding Foreign Partnership or Trust Agreements as a Result of F.A.T.C.A.** Many partnerships and trusts have entered into withholding agreements with the I.R.S. in order to protect information on members and beneficiaries. Galia Antebi and Nina Krauthamer explain new obligations related to F.A.T.C.A.

- **Current Tax Court Litigation Illustrates Intangible Property Transfer Pricing and Valuation Issues.** Robert Rinninsland and Philip Hirschfeld discuss issues in two cases now before the Tax Court. I.R.S. positions on transfer pricing for I.P. and outbound contributions of I.P. reflect a "get-tough" approach to possessions corporations converting to C.F.C.'s.

- **I.R.S. Issues New Form 1023-EZ: Streamlined Exemption for Small Charities.** Nina Krauthamer explains the simplified provisions that allow small public charities to apply for recognition of tax-exempt status.

- **Corporate Inversion Transactions: Tax Planning as Treason or a Case for Reform?** Robert Rinninsland and Cheryl Magat place inversion transactions in context and suggest a reasonable approach to the issues faced in a global economy that knows no borders.

- **Corporate Matters: Delaware or New York L.L.C.?** That question faces many persons when a business or investment is to be located in New York. Nina Krauthamer discusses the factors that may lead to an answer.

- **F.A.T.C.A. 24/7.** Philip Hirschfeld continues his update on recent F.A.T.C.A. events. He addresses Israel as an enforcer of F.A.T.C.A., information regimes abroad that are more demanding than F.A.T.C.A., and litigation in Canada to prevent disclosure by the Canadian government.

- **The U.S.–Sweden I.G.A.: A Practitioner's Perspective.** Peter Utterström of Hellström Advokatbyrå KB, Stockholm, Sweden and Philip Hirschfeld discuss how Swedish financial institutions are preparing to comply with F.A.T.C.A. obligations – some are and others are not.

- **Updates and Other Tidbits.** Robert Rinninsland and his team address foreign tax credits for U.K. windfall taxes, scam phone calls to taxpayers requesting private data, new I.T.I.N. rules, another inversion announcement, and Singapore transfer pricing information requirements.

We hope you enjoy this issue.

-The Editors

INBOUND INVESTMENT IN GERMAN REAL ESTATE

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Tags
Germany
International Tax
Real Estate
Real Estate Tax
Real Estate Transfer Tax
Trade Tax

INTRODUCTION

Investments in German real estate are attractive to international investors. Low interest rates and positive economic conditions exist in Germany. The demand for commercial and residential rental properties has increased in urban centers such as Berlin, Düsseldorf, Frankfurt, Hamburg, Cologne, Munich, and Stuttgart. In these circumstances, it is expected that Germany will remain an attractive market for real estate investments.

Germany provides reliable political conditions, which are advantageous for a successful investment. However, there is an increasing complexity to the general legal conditions, and the success of a real estate investment strongly depends on proper structuring of the investment in a tax-efficient way.

This article provides an overview of the tax consequences of inbound investments in German real estate.

Different investment structures are compared:

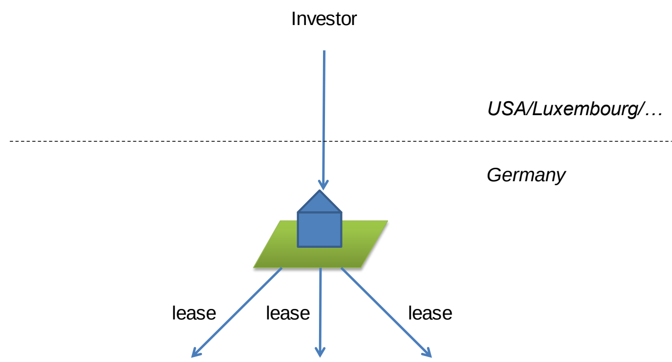
- Holding the property directly,
- Holding shares in a property company, and
- Holding interests in a property partnership.

In addition to income tax, German real estate transfer tax aspects are discussed, and planning opportunities to reduce or eliminate German trade tax are explored.

Dr. Petra Eckl is a lawyer, tax advisor, and partner at GSK Stockmann + Kollegen in Germany, where her practice focuses on tax advice in connection with cross-border and domestic transactions and tax litigation. Dr. Eckl is a lecturer at Frankfurt University and regularly publishes articles on German tax developments.

DIRECT INVESTMENT

Fig.: Foreign investor based in the U.S. or Luxembourg holds German real estate directly.



Income Tax

The income of a foreign individual or company derived from a property located in Germany is subject to a limited tax liability (*"beschränkte Steuerpflicht"*) and generally benefits from provisions that avoid double taxation of the income generated in Germany. In general, German double taxation treaties ("D.T.T.'s") provide the right to tax income resulting from real estate to the country in which the real estate is located.[1] This also applies to income derived from real estate generated by a commercial business.[2] Of course, if the investor is a U.S. tax resident, the U.S. retains a residual right to tax the income under the "saving clause" of the D.T.T. with the U.S. in virtually all circumstances.[3]

In the case of an individual investor, the German income tax (*"Einkommensteuer"*) rate depends on the amount of the taxable income reported by the individual. The tax rate is progressive and can amount to as much as 45% (plus a solidarity surcharge of 5.5%, combined at 47.475%, and if applicable, church tax).

In the case of a corporate investor, the corporate income tax (*"Körperschaftsteuer"*) rate amounts to 15% (plus solidarity surcharge of 5.5%, combined 15.825%).

The rules for determining taxable income from rental properties are almost the same for individuals, partnerships or corporations. The acquisition costs of non-residential buildings are usually depreciated at an annual rate of between 2% and 3%. Expenses incurred regarding the real estate investment (*e.g.*, property management fees) are generally deductible for tax purposes.

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1 See for instance Art. 6 (1) O.E.C.D.-D.T.T.; Art. 6 (1) D.T.T. between Germany and the U.S.; Art. 6 (1) D.T.T. between Germany and Luxembourg.

2 See for instance Art. 6 (4) O.E.C.D.-D.T.T.; Art. 6 (4) D.T.T. between Germany and the U.S.; Art. 6 (4) D.T.T. between Germany and Luxembourg.

3 See Art. 1 (4) of the D.T.T. between Germany and the U.S.

With respect to the deduction of interest expenses, special restrictions apply. According to the so-called interest barrier rule (*"Zinsschranke"*),[4] interest expense is deductible for tax purposes only to the extent that the expense does not exceed 30% of the so-called "Tax E.B.I.T.D.A." of the respective property entity, *i.e.*, the E.B.I.T.D.A. adjusted for tax purposes. Interest expenses that are disallowed by the interest barrier rule can be recorded as interest carryforwards and may, under certain circumstances, be deducted for tax purposes in future financial years. Note that the interest barrier rule does not apply if the relevant interest amount (*i.e.*, interest income minus interest expenses) is less than €3 million per annum.

Trade Tax

German trade tax (*"Gewerbesteuer"*) is a special tax for entrepreneurs that perform commercial activities in Germany. The trade tax rate depends on the municipality where the real estate (or the business) is located. The average tax rate amounts to 15%.[5] Trade tax is not a business expense for income tax purposes. However, in the case of an individual who is subject to income and trade tax, the trade tax can be partly deducted from income tax liability.[6]

Investments in real estate can often be structured in a way that no trade tax applies if the investor simply holds real estate and leases it to other parties. However, in case of commercial business activity (trading property), German trade tax will almost always apply.

Commercial vs. Non-commercial Activities

The income from the mere leasing of a property typically is not considered to be "commercial" income. Rather, it is considered to be income from property management (*"Vermögensverwaltung"*). As a consequence, mere leasing activity is usually not subject to German trade tax.

Income from leasing is considered to be commercial income and, therefore, subject to German trade tax only when circumstances exist which are typical of commercial activities. These circumstances include the conduct of a business model involving a high number of customers renting for short periods or the provision of further services that are not typical of a non-commercial owner/lessor.

The factors that distinguish commercial leasing operations from non-commercial leasing operations also apply to foreign investors. Therefore, if properly structured, a foreign investor who directly invests in German real estate may be able to avoid trade tax.

Avoidance of a German Permanent Establishment in Case of Leasing Real Estate

A foreign investor, who directly invests in German real estate, is subject to trade tax only if there is a permanent establishment, for trade tax purposes, in Germany.

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4 See Sec. 4h German Income Tax Act (*"Einkommensteuergesetz"*).

5 *E.g.*, 17.15% in Munich, 16.1% in Frankfurt/Main or 14.35% in Berlin.

6 If the trade tax rate of the local municipality exceeds 13.3%, the exceeding trade tax cannot be deducted. See Sec. 35 (1) German Income Tax Act.

Under German local tax law a German permanent establishment is any fixed place of business or facility that serves the business of an enterprise.[7] The fixed place of business must serve the enterprise for a certain minimum period of time and must be at the disposal of the enterprise.

If the only activity of a lessor in Germany is the simple lease of property, a permanent establishment of the lessor will usually not be established. The lease of property itself is not considered as a commercial business.

"If the only activity of a lessor in Germany is the simple lease of property, a permanent establishment of the lessor will usually not be established. The lease of property itself is not considered as a commercial business."

Where, however, the lessor provides further services through its own employees to the *lessee*, such as maintenance of the building, caretaker services, and the like, a permanent establishment could exist. This would bring the lessor within the charge to trade tax. Consequently, investments are often structured in a way that such services are rendered by a third party service provider. It is believed that this should enable the foreign investor to avoid a German permanent establishment, at least, if the service provider is not supervised by the lessor and if the lessor has no right to use the fixed place of business of the service provider. Note that a recent judgment of the Federal Tax Court suggests that a different conclusion can exist in specified circumstances.

Similarly, the lessor should not retain any rights of use regarding the leased property; mere lease activity exists only where the lessee has the right to use the property. If the lessor has the right to use parts of the property and actually uses them for its business, a permanent establishment of the lessor's business can exist. An example of such use is a storage room for the maintenance documents or other items of property. Use of the property by the lessor is important because the existence of vacant space in the rented building should not constitute a permanent establishment. Empty space is not considered to be used by the lessor.

Care must also be taken to avoid an "agency permanent establishment" (*"Vertreterbetriebstätte"*).[8] If a third party service provider is involved in the management of the property, it should not engage in any management activities that are necessary for the conduct of the business. If it does, an agency permanent establishment may exist. Thus, for example, a third party services provider should not be allowed to conclude or cancel any agreements in the name of the lessor.

Similarly, management activities in Germany must be minimized with respect to the property to prevent a management permanent establishment from existing. Note that relatively minor management activities will not rise to the level of a permanent establishment. Thus, for example, an asset or facility manager who is responsible for making only minor business decisions in Germany is likely not a permanent establishment. On the other hand, an asset or facility manager that is allowed to sign contracts on behalf of the lessor is likely a permanent establishment.

Extended Trade Tax Deduction

Even if a business is subject to German trade tax by virtue of a permanent establishment for trade tax purposes, the so-called "extended trade tax deduction"

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7 See Sec. 12 German General Tax Code (*"Abgabenordnung"*).
8 See Sec. 13 German General Tax Code.

(*"erweiterte gewerbesteuerliche Kürzung"*)[9] can help to prevent a trade tax payment in the case of real estate leasing. In order to benefit from this deduction, the business activities must be limited to the management of real estate property owned by the investor and/or capital investments. All other activities are harmful. The interpretation of this provision by the German tax authorities is very strict and formal. Owned "real estate property" means legally owned real estate only. Therefore, the lease of property would, for instance, be detrimental. Operating facilities that are part of the property from a civil law perspective are not part of the "property" from a trade tax perspective. Thus, the lease of property with included operating facilities would be detrimental for the application of the extended trade tax deduction.

Comparison of Income and Trade Tax Consequences

If a foreign company or individual invests in German real estate, the question of whether the investment qualifies as a German permanent establishment for trade tax purposes is crucial. If it qualifies as a permanent establishment for trade tax purposes, the income derived from the investment will not only be subject to German income tax, but also to German trade tax if the extended trade tax deduction cannot be applied.

Example 1:

A property located in Frankfurt/Main, Germany, is leased. The taxable income from the lease of the property amounts to €1 million. The lessor is located in the U.S. or Luxembourg and maintains no permanent establishment for trade tax purposes in Germany. Trade tax does not apply.

German Tax Consequences:

	Individual as Lessor	**Company as Lessor**
Income Tax Rate	47.475%	15.825%
Income Tax	€474,750	€158,250
Trade Tax	No	No
Overall Tax Burden	**€474,750**	**€158,250**

Example 2:

The lessor maintains a permanent establishment in Frankfurt/Main from which numerous additional commercial services are provided to the lessee. The lessor is subject to German trade tax.[10] *The preconditions of the extended trade tax deduction are not met.*

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9 See Sec. 9 no. 1 s. 2 German Trade Tax Act.

10 For individuals and partnerships a trade tax exemption in the amount of

German Tax Consequences:

	Individual as Lessor	Lessor as Company
Income Tax Rate	47.475%	15.825%
Income Tax	€474,750	€158,250
Trade Tax Rate[11]	16.1%	16.1%
Trade Tax	€161,000	€161,000
Trade Tax Deduction	€133,000[12]	No
Income Tax Burden	€341,750	€158,250
Overall Tax Burden	**€502,750**	**€319,250**

Thus, for a foreign investor, it is extremely important for German income tax to be reduced through the use of a corporation and for German trade tax to be reduced or eliminated through the absence of a permanent establishment.

Exit/Sale of Real Estate

If a foreign investor sells real estate that is located in Germany, most of the German double taxation treaties allocate the right to tax potential capital gains to Germany. If the investor is located in a country with which Germany has not concluded a double taxation treaty, Germany has the right to tax potential capital gains according to German local tax law. The foreign investor is subject to limited tax liability. The potential tax burden depends on the concrete income tax rate. In the case of an individual, the rate is typically up to approximately 47%, as discussed above. In the case of a corporate investor, the tax rate amounts to approximately 15%, as discussed above. Also as mentioned above, trade tax is due if the foreign investor maintains a German permanent establishment for trade tax purposes.

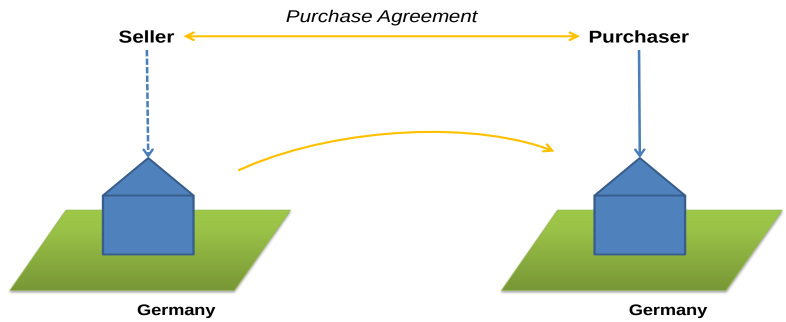
€24,500 would be applicable. This is not considered in the example.

11 Municipal trade tax rate of 3.5% (basic federal rate) x 460% (local trade tax multiplier).

12 If the trade tax rate of the local municipality exceeds 13.3%, not the whole trade tax can be deducted. See Sec. 35 (1) German Income Tax Act.

Real Estate Transfer Tax

Fig.: Real estate, which is located in Germany, is sold.



In Germany, the transfer of a property is subject to real estate transfer tax ("*Grunderwerbsteuer*," in the following: "R.E.T.T."). The tax rates vary from one German Federal State ("*Bundesland*") to another. Currently, the tax rates range between 3.5% and 6.5%.

State *("Bundesland")*	**Tax Rate**	**In Effect**
Baden-Wurttemberg	5.0%	11/05/2011
Bavaria	3.5%	01/01/1997
Berlin	6.0%	01/01/2014
Brandenburg	5.0%	01/01/2011
Bremen	5.0%	01/01/2014
Hesse	6.0%	08/01/2014
Lower Saxony	5.0%	01/01/2014
Mecklenburg-Western Pomerania	5.0%	07/01/2012
North Rhine-Westphalia	5.0%	10/01/2011
Rhineland-Palatinate	5.0%	03/01/2012
Saarland	5.5%	01/01/2013
Saxony	3.5%	01/01/1997
Saxony-Anhalt	5.0%	03/01/2012
Schleswig-Holstein	6.5%	01/01/2014
Thuringia	5.0%	04/07/2011

Asset transactions involving real estate located in Germany trigger the imposition of

R.E.T.T.[13] The tax base is the value of the consideration given by the purchaser.[14] In most cases this will be the purchase price. However, the tax base can be increased by additional benefits provided by the purchaser, such as the redemption of a mortgage by the purchaser or the grant of a royalty-free right of use in favor of the seller. The purchaser and the seller are jointly subject to tax.[15] In practice, however, most asset deal purchase agreements allocate the tax burden to the purchaser.

Example 3:

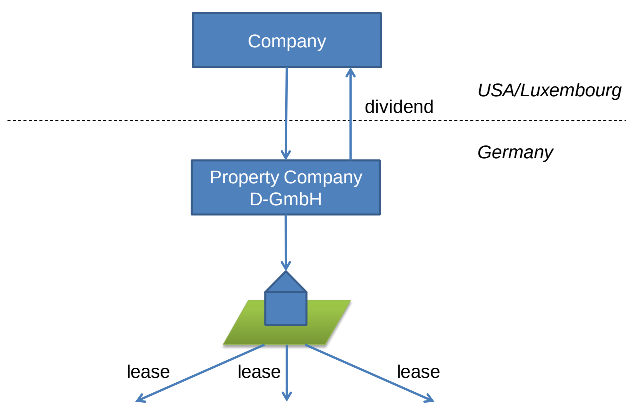
The purchase price of the property amounts to €1 million. No further benefits are provided. The property is located in Frankfurt/Main.

German Tax Consequences:

For R.E.T.T. purposes, the tax base amounts to €1 million. As the property is located in Frankfurt (Hesse), the rate of R.E.T.T. amounts to 6%. Thus, the R.E.T.T. burden amounts to €1,000,000 x 6% = €60,000.

INBOUND INVESTMENT VIA A PROPERTY COMPANY

Fig.: Foreign corporate investor acquires shares in a German property company.



If German real estate is held by a company, the income of the company is subject to corporate income and trade tax[16] in Germany.

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13 See Sec. 1 (1) no. 1 German R.E.T.T. Act.
14 See Sec. 8 (8) German R.E.T.T. Act.
15 See Sec. 13 no. 1 R.E.T.T. Act.
16 As mentioned above, the trade tax is imposed at full rates only if the extended trade tax deduction cannot be used.

The profit distribution from the German company to the foreign parent company is subject to German withholding tax. The local withholding tax rate amounts to 25% or – if substance requirements are met – to 15%. However, German double taxation treaties and the E.U. Parent-Subsidiary Directive reduce or eliminate the withholding tax rate.

In general, dividend payments to the U.S. are subject to withholding tax at a rate of 15%.[17] It can be reduced to 5% if the parent company owns at least 10% of the voting shares of the dividend-paying company.[18] The tax is entirely eliminated if the parent company owns at least 80% of the voting shares of the dividend-paying company and further requirements are met.[19] If the parent company resides in Luxembourg, the withholding tax can be eliminated under the E.U. Parent-Subsidiary Directive.[20]

The income of a German GmbH always qualifies as "commercial" and is subject to German trade tax. However, the extended trade tax deduction can be applicable. The deduction is available only if the business activities are limited to the management of real estate and/or capital investments owned by the GmbH (see above).

Example 4:

"D-GmbH" is located in Frankfurt/Main where it owns and leases property. The property is fully managed by D-GmbH. The taxable income from the lease of the property amounts to €1 million. The profits of D-GmbH are distributed to the parent company which is resident in the U.S. or in Luxembourg.

German Tax Consequences for the Rental Income:

	Company	**Company, Extended Trade Tax Deduction Applicable**
Income tax rate	15.825%	15.825%
Income tax	€158,250	€158,250
Trade tax rate[21]	16.1%	16.1%
Trade tax	€161,000	€0
Overall tax burden	**€319,250**	**€158,250**

17 See Art. 10 (2) lit. b D.T.T. between Germany and the U.S.

18 See Art. 10 (2) lit. a D.T.T. between Germany and the U.S.

19 See Art. 10 (3) D.T.T. between Germany and the U.S.

20 There are certain substance requirements for the parent company for a reduction of the withholding tax (*e.g.*, office, employees, etc.), see Sec. 50d (3) German Income Tax Act.

21 Municipal trade tax rate of 3.5% (basic federal rate) x 460% (local trade tax multiplier).

The profit distribution from D-GmbH to a parent company located in the U.S. or Luxembourg can also be subject to German withholding tax.[22] The tax rate may be reduced to 0% according to provisions of D.T.T.'s or the E.U. Parent-Subsidiary Directive.

Exit/Sale of Shares

According to German local tax law, the income of a company derived from the sale of shares in another company is tax-exempt.[23] However, a partial tax is due because 5% of the capital gain is deemed to be a non-deductible business expense, which increases the taxable income.

According to most German D.T.T.'s, profits derived by a foreign shareholder from the sale of shares of a German GmbH are not subject to German taxation. Usually, the country of residence of the shareholder has the right to tax potential capital gains. However, some recent D.T.T.'s provide special rules for the sale of shares in companies whose assets consist of more than 50% "immovable assets" – the technical term in the treaty for real estate. Where such conditions exist, the treaty may allocate the right to tax potential capital gains from the sale of shares to the country where its underlying real estate is primarily located.[24] If the target company is German and the underlying real property is located in Germany, the foreign shareholder may claim the 95% exemption of German domestic law.

Example 5:

The parent company, which is located in the U.S. or Luxembourg, sells 100% of the shares in D-GmbH. The purchase price is €1 million. The book value of the shares amounts to €500,000. Thus, the capital gain amounts to €500,000.

German Tax Consequences:

Capital gain	€500,000
Tax exemption (95%)	€475,000
Taxable income	€25,000
Tax rate	15.825%
Income Tax	**€3,956.25**

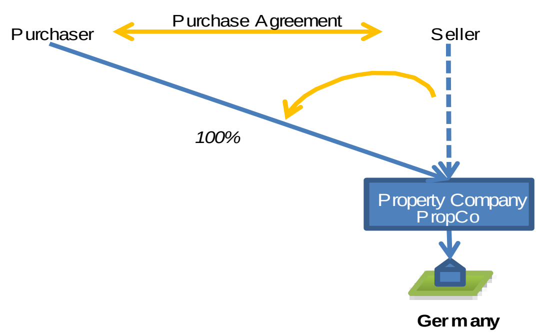
Germany has the right to tax the income derived from the sale of the shares if the assets of D-GmbH consist of more than 50%immovable assets.[25] The U.S. avoids double taxation of such income by offsetting

[22] If certain substance requirements are met.
[23] See Sec. 8b (2) German Corporate Income Tax Act.
[24] See Art. 13 (2) D.T.T. between Germany and the U.S.; Art. 13 (2) D.T.T. between Germany and Luxembourg.
[25] See Art. 13 (2) D.T.T. between Germany and the U.S. and Art. 13 (2) D.T.T. between Germany and Luxembourg.

the German tax against the domestic tax (credit method).[26] Luxembourg, in this case, exempts from tax the income which is subject to tax in Germany (exemption method).[27]

Real Estate Transfer Tax

Fig.: 100% of the shares in a property company, which holds real estate that is located in Germany, are sold.



German R.E.T.T. is triggered if at least 95% of "shares" (*"Anteil der Gesellschaft"*) in a real estate owning company are acquired by one person.[28] The shares may be acquired directly by one person or indirectly through a multi-tier participation structure. The 95% ownership trigger may also result from several steps in an integrated series of acquisitions.

The tax base is the real property value pursuant to the German Valuation Act (*"Bewertungsgesetz"*). This is a special valuation of real estate for tax purposes.[29] The person that acquires the 95% interest is subject to R.E.T.T.[30]

Example 6:

The Seller transfers all of the shares in the real estate owning company to the Purchaser. The market value of the real estate amounts to €1

26 See Art. 23 (1) D.T.T. between Germany and the U.S.

27 See Art. 22 (2) lit. a D.T.T. between Germany and Luxembourg.

28 See Sec. 1 (3) German R.E.T.T. Act. The provision is also applicable to real estate owning partnerships. However, in the case of a partnership, every partner holds one "share" (*"Anteil der Gesellschaft"*) in the sense of this provision. This means that even a partner without participation in the assets of the partnership (*e.g.*, a general partner) is a joint owner of the partnership. As a result, a direct unification of the "shares" in a partnership in one hand is impossible. Thus, the provision of Sec. 1 (3) German R.E.T.T. Act is less important for partnerships than for companies.

29 However, the German Federal Tax Court (*"Bundesfinanzhof"*) appealed to the German Constitutional Court (*"Bundesverfassungsgericht"*) whether the use of the real property value as tax base for R.E.T.T. purposes is in accordance with the German constitution (German Federal Tax Court of 2 March 2011, II R 23/10). The German Constitutional Court has not decided yet (1 BvL 13/11).

30 See Sec. 13 no. 5 German R.E.T.T. Act.

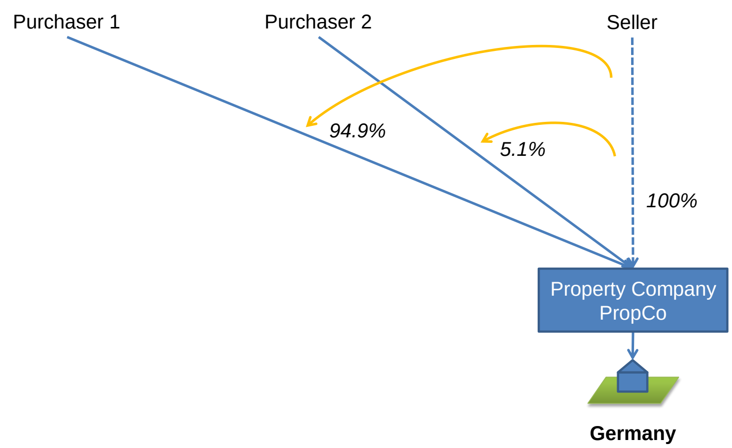
million. It is assumed that the real property value amounts to 60% of the market value. The company and the property are located in Frankfurt/Main.

German Tax Consequences:

The R.E.T.T. burden amounts to €600,000 x 6% = €36,000.

In 2013, Germany passed a law to abolish traditional R.E.T.T. blocker structures. Previously, R.E.T.T. could be avoided by the participation of an independent third party via an intermediary company or several intermediary companies. By using a multi-tier structure the economic participation of the third party could be minimized to a very small percentage rate. Now R.E.T.T. is also triggered if the acquirer's economic participation quota in the real estate owning company or partnership amounts to 95% or more.[31]

Fig.: Avoidance of R.E.T.T. in a share deal scenario.



As a result, a common way to avoid R.E.T.T. is to ensure that a third party holds immediately at least 5.1% of the shares or interests in the real estate owning company or partnership. The third party can be the seller or any other independent party.

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[31] See Sec. 1 (3a) German R.E.T.T. Act.

Example 7:

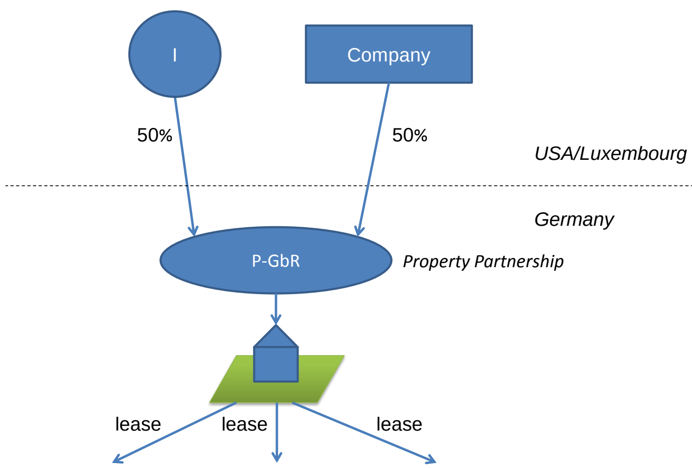
The Seller transfers 94.9% of the shares in PropCo to Purchaser 1 and 5.1% to Purchaser 2. Purchaser 2 must be independent from Purchaser 1 from a R.E.T.T. perspective.[32]

German Tax Consequences:

There is no taxable event. Less than 95% of the shares are acquired by one shareholder.[33]

INBOUND INVESTMENT VIA A PROPERTY PARTNERSHIP

Fig.: A foreign individual ("I") and a foreign corporate investor ("Company") acquire interests in a German property partnership ("P-GbR").



Under German tax law, partnerships are transparent for income tax purposes. Only the partners, but not the partnerships themselves, are subject to (corporate) income tax.

However, if the partnership is a commercial partnership, the partnership itself is subject to German trade tax.

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32 "Independent third party" for R.E.T.T. purposes means that there are no real or corporate relationships between entities or persons with respect to each other. Furthermore, there must be no agreements which result in a different allocation of the beneficial ownership in the shares pursuant to Sec. 39 (2) German Tax Code.

33 However, if PropCo is a partnership, R.E.T.T. will be triggered pursuant to Sec. 1 (2a) German R.E.T.T. Act as at least 95% of the interests in the partnership are transferred to new partners. See *Example 12*.

The qualification as “commercial” or “non-commercial” *inter alia* depends on the question of whether the partnership generates commercial income or “only” income from property management. Real estate partnerships can often be structured in a way so that they do not generate commercial income.

Example 8:

The non-residential individual, I, and a Luxembourg or U.S. company are partners in the German partnership P-GbR (participation quota: 50% each). P-GbR is the legal owner of property located in Frankfurt/Main. The taxable income from the lease of the property amounts to €1 million. The activities of P-GbR are non-commercial. There is no permanent establishment in Germany for trade tax purposes.

German Tax Consequences for Rental Income:

	Individual (50%)	**Company (50%)**
Taxable Income	€500,000	€500,000
Income Tax Rate	47.475%	15.825%
Income Tax	€237,375	€79,125
Overall Tax Burden	**€237,375**	**€79,125**

Example 9:

The activities of P-GbR are commercial due to the provision of various additional commercial services to the lessee. Therefore, P-GbR is subject to German trade tax.[34]

German Tax Consequences for Rental Income:

Trade Tax Rate	16.1%	
Trade Tax[35]	€161,000	
	Individual (50%)	**Company (50%)**
	P-GbR	
Taxable Income	€500,000	€500,000
Income Tax Rate	47.475%	15.825%
Income Tax	€237,375	€79,125

34 For individuals and partnerships a trade tax exemption in the amount of €24,500 would be applicable but is not considered in this example.

35 Municipal trade tax rate of 3.5% (basic federal rate) x 460% (local trade tax multiplier).

Trade Tax Deduction[36]	€66,500[37]	No
Income Tax Burden	€170,875	€79,125
Overall Tax Burden[38]	**€251,375**	**€159,625**

Exit/Sales of Interests

From a tax perspective, the sale of an interest in a partnership is treated as a sale of the assets of the partnership.

Germany has the right to tax the income derived from the sale of the interests of a real estate owning partnership.[39] The U.S. sets off the German tax against the domestic tax to avoid double taxation of such income.[40] Luxembourg exempts the income from domestic tax, which is subject to tax in Germany.[41]

Example 10:

The partners sell their interests in the non-commercial partnership P-GbR. The purchase price for each interest is €500,000. book value of each interest amounts to €250,000. Thus, the capital gain amounts to €250,000. The interests were held for about five years.

German Tax Consequences:

	Individual (50%)	Company (50%)
Taxable Income	€250,000[42]	€250,000
Income Tax Rate	47.475%	15.825%
Income Tax	**€118,687.50**	**€39,562.50**

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36 Partly set off in the amount of the profit distribution quota, which usually equals to the participation quota.

37 If the trade tax rate of the local municipality exceeds 13.3%, only a portion trade tax may be deducted.

38 The overall tax burden of the partners is calculated by the income tax burden of the partners and partial consideration of the trade tax burden of the partnership.

39 See Art. 13 (2) D.T.T. between Germany and the USA and Art. 13 (1) D.T.T. between Germany and Luxembourg.

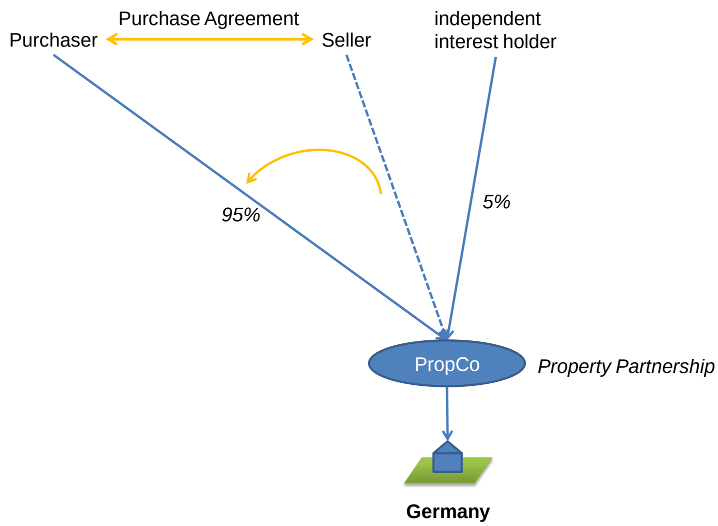
40 See Art. 23 (1) D.T.T. between Germany and the USA. The gain is treated as arising in Germany for purposes of the foreign tax credit limitation. See Art. 23 (2) D.T.T. between Germany and the USA.

41 See Art. 2 (2) lit. a D.T.T. between Germany and Luxembourg.

42 If the property was held for more than ten years by P-GbR and the individual partners held their interests in P-GbR for more than ten years, the profit from the sale of the interests would not be subject to German income tax. There was a recent decision by the Tax Court of Munich (FG Munich of July 29, 2013, 7 K 190/11) in which the court concluded that this exemption also applies for corporate partners. The case is facing appeal. German tax authorities may be of a different opinion. For individuals and partnerships a trade tax exemption in the amount of €24,500 would be applicable, but this exemption is not within the scope of this example.

Real Estate Transfer Tax

Fig.: 95% of the interests in a partnership that owns real estate located in Germany are sold.



German R.E.T.T. is triggered if at least 95% of the interests in a real estate owning partnership are transferred directly or indirectly to new partners within a period of five years.[43] This is also true if interests in the relevant amount are acquired in several successive steps within the five-year period by one or more acquiring parties. The tax base is the real property value according to the German Valuation Act.[44] The partnership is subject to R.E.T.T.[45]

Example 11:

The Seller transfers 95% of the interests in PropCo to the Purchaser. The remaining 5% is held by an independent third party. The market value of the real estate amounts to €1 million. It is assumed that the real property value amounts to 60% of the market value. The partnership and the property are located in Frankfurt/Main.

German tax consequences:

The transfer of interests is subject to R.E.T.T. The R.E.T.T. burden amounts to €600,000 x 6% = €36,000.

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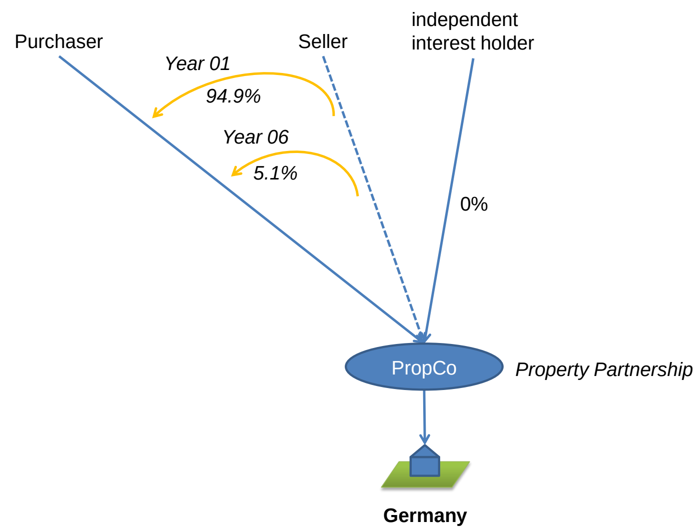
43 See Sec. 1 (2a) German R.E.T.T. Act.

44 There is the question whether the use of the real property value as tax base for R.E.T.T. purposes is in accordance with the German constitution. See footnote 29.

45 See Sec. 13 (6) no. 6 R.E.T.T. Act.

R.E.T.T. may be avoided if the seller or another partner of the partnership retains more than 5% of the interests. However, the involvement of a third party is not always an optimal solution.

Fig.: Reduction of R.E.T.T. by the acquisition in two tranches.



Example 12:

In the first year the Seller transfers 94.9% of the interests in PropCo to the Purchaser. In the sixth year (after the expiration of the five-year holding period) the remaining 5.1% of the interests are transferred to the Purchaser. The market value of the real estate amounts to €1 million. It is assumed that the real property value amounts to 60% of the market value. The partnership and the property are located in Frankfurt/Main.

German Tax Consequences:

In the first year no R.E.T.T. is triggered because less than 95% of the interests in ProCo are transferred to new partners.

However, R.E.T.T. is triggered in the sixth year. A transaction is also subject to R.E.T.T. if it results in an economic participation in the property company amounting to 95% or more.[46] The economic participation is calculated by addition of the direct or indirect participation quotas. However, due to the fact that the Purchaser had held an interest of 94.5% for more than five years, tax is not charged in the amount of his participation quota of 94.9% according to another special tax-exemption provision.[47] Therefore, R.E.T.T. is

46 See Sec. 1 (3a) German R.E.T.T. Act.
47 See Sec. 6 (2) German R.E.T.T. Act.

finally only triggered with respect to the participation quota of 5.1%. The R.E.T.T. burden amounts in total to €600,000 x 6% x 5.1% = €1,836.

CONCLUSION

There is no general answer to whether it is preferable for a foreign investor to make a direct investment, an investment into a property company, or a property partnership. Whichever structure is chosen, it is important to adopt a plan that eliminates German trade tax. German trade tax is not applicable if a permanent establishment for trade tax purposes is not constituted or if the “extended trade tax deduction” applies.

In general, investment in a property company is an advantageous structure because of the relatively low German corporate income tax rate of only approximately 15%. A property company is also a good structure with respect to a potential exit because capital gains derived from the sale of shares held by another company are almost entirely tax-exempt under German law.

Direct investment by an individual appears to be less advantageous because the tax rate is substantially greater for individuals, topping out at approximately 47%.

With respect to investments through a partnership, the tax consequences are determined at the partner level. No matter the make-up of the partnership group, operations should be carried on to avoid commercial partnership status. If the partnership is not a commercial partnership, German trade tax will not be applicable.

With respect to the German real estate transfer tax, a direct investment in the real estate is regularly disadvantageous because there is usually no way to avoid or minimize the real estate transfer tax burden.

Due to several amendments of the Real Estate Transfer Act in the past, it has become more difficult to set-up tax efficient acquisition structures for “share deals.” However, R.E.T.T. can usually be avoided if a third party is involved in the investment as co-investor. Another possibility to reduce the tax burden is the investment into a property partnership. If the investment is planned within a time-period of more than five years, the acquisition structure can be set up to avoid almost 95% of the real estate transfer tax.

TAX 101: UPDATES TO PROCEDURES RELATING TO WITHHOLDING FOREIGN PARTNERSHIP OR TRUST AGREEMENTS AS A RESULT OF F.A.T.C.A.

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Tags
F.A.T.C.A.
Withholding Partnership
Withholding Trust

Chapter 3 of the Internal Revenue Code requires withholding on payments of certain types. These include "fixed or determinable annual or periodic income" ("F.D.A.P.") to foreign persons, disposition of U.S. real property interests by foreign persons, and U.S. effectively connected income attributable to foreign partners of a partnership engaged in a U.S. trade or business. Historically, withholding agreements allowed a foreign partnership or trust to become a Withholding Foreign Partnership ("W.P.") or a Withholding Foreign Trust ("W.T.") and to assume the withholding and reporting responsibilities of a withholding agent under Chapter 3.

Chapter 4 of the Internal Revenue Code (regarding F.A.T.C.A.) generally requires foreign financial institutions ("F.F.I.'s") to provide information to the Internal Revenue Service ("I.R.S.") with regard to account holders who are U.S. persons. Chapter 4 also requires certain non-financial foreign entities ("N.F.F.E.'s") to provide information on their substantial U.S. owners to withholding agents. Chapter 4 imposes a withholding tax on certain payments to F.F.I.'s and N.F.F.E.'s that fail to comply with their F.A.T.C.A. obligations. (For a more detailed discussion of F.A.T.C.A., please see our *Insights* monthly F.A.T.C.A. 24/7 column.)

On August 8, 2014, the I.R.S. released Rev. Proc. 2014-47,[48] which provides guidance on entering into W.P. and W.T. agreements and for renewing such agreements under F.A.T.C.A., thereby essentially integrating the two reporting systems. Rev. Proc. 2014-17 permits a W.P. and W.T. to assume the withholding and reporting responsibilities of a withholding agent under both Chapter 3 and Chapter 4. Rev. Proc. 2014-47 publishes revised W.P. and W.T. agreement procedures, which apply to W.P. and W.T. agreements effective on or after June 30, 2014. Additionally, existing W.P. and W.T. agreements are updated to coordinate with the withholding and reporting requirements of F.A.T.C.A.

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[48] Rev. Proc. 2014-47 can be found here: http://www.irs.gov/pub/irs-drop/rp-14-47.pdf.

IN GENERAL

The revised W.P. or W.T. agreements require a W.P. and W.T. to assume F.A.T.C.A. withholding responsibilities in addition to Chapter 3 withholding responsibilities. With respect to a withholdable payment of U.S.-source F.D.A.P. income that is subject to Chapter 3 withholding and that is not subject to withholding under Chapter 4 (F.A.T.C.A.), a withholding agent is required to report the applicable F.A.T.C.A. exemption code in addition to other information required to be reported. Amounts withheld under F.A.T.C.A. can be credited against liability or tax under Chapter 3.

Applications for new agreements must establish to the satisfaction of the I.R.S. that the applicant has adequate resources and has established appropriate practices and procedures to comply with the terms of the W.P. or W.T. agreement. An application must include the information required by Form 14345 (Qualified Intermediary Application), a completed Form SS-4 (Application for Employer Identification Number), and any additional information and documentation requested by the I.R.S. Once the W.P. or W.T. application is approved, the I.R.S. will send an approval notice including a W.P.-E.I.N. or W.T.-E.I.N. assigned to the entity. This identification number will be employed when fulfilling the requirements of a W.P. or W.T. under Chapters 3 and 4, such as making tax deposits and filing Forms 1042, 1042-S, and 8966.

A W.P. or W.T. that has: (i) executed a W.P. or W.T. agreement, (ii) seeks to renew its W.P. or W.T. agreement, and (iii) intends to register (or has registered) as a participating F.F.I., registered deemed-compliant F.F.I., or sponsoring entity, must do so by submitting a registration form through the F.A.T.C.A. registration website and including the information requested for renewal. Upon completion of the registration process and approval by the I.R.S., a W.P. or W.T. will be issued a G.I.I.N. to be used to identify its F.A.T.C.A. (Chapter 4) status to withholding agents and to tax administrators, if applicable, for F.A.T.C.A. reporting. A W.P. or W.T. will retain its previously issued W.P.-E.I.N. or W.T.-E.I.N. for fulfilling the requirements of a W.P. or W.T.

An existing W.P. or W.T. that is a retirement fund or an N.F.F.E. that is not a sponsoring entity[49] may not use the F.A.T.C.A. registration website and must renew its W.P. or W.T. agreement by submitting a request for renewal to the Foreign Intermediaries Program. Such entities will not need to obtain a G.I.I.N.

A W.P. or W.T. will be required to report partners, beneficiaries, or owners that are U.S. non-exempt recipients on Form 8966 (F.A.T.C.A. Report), Schedule K-1 (Form 1065), or Form 3520-A (Annual Information Return of Foreign Trust with a U.S. Owner) to the extent required under the W.P.'s or W.T.'s F.A.T.C.A. requirements or the W.P. or W.T. agreement.

[49] As defined in §1.1471-1(b)(124).

THE REVISED AGREEMENTS

The new procedures require that a W.P. or W.T. that is an F.F.I. (other than a retirement fund) will agree to satisfy the requirements and obligations of its specific F.F.I. status. The applicable F.F.I. statuses include: (i) a participating F.F.I. (including a reporting Model 2 F.F.I.), (ii) a registered deemed-compliant F.F.I. (including a reporting Model 1 F.F.I. and a non-reporting Model 2 F.F.I. treated as registered deemed-compliant), or (iii) a registered deemed-compliant Model 1 I.G.A. F.F.I. An F.F.I. that is treated as a certified deemed-compliant F.F.I. may enter into a W.P. or W.T. agreement if it agrees to assume the responsibilities of one of the abovementioned statuses.

An F.F.I. that enters into a W.P. or W.T. agreement will be subject to F.A.T.C.A. obligations with respect to all of its partners, beneficiaries, or owners that are account holders for F.A.T.C.A. purposes, irrespective of whether the F.F.I. is acting as a W.P. or W.T. with respect to the partner, beneficiary, or owner. When an F.F.I. chooses to act as a W.P. or W.T. with respect to a partner, beneficiary, or owner that is an account holder for F.A.T.C.A. purposes, the W.P. or W.T. must comply with its F.A.T.C.A. obligations, except when such obligations have been explicitly modified in the W.P. or W.T. agreement (*e.g.*, the timing for when a W.P. or W.T. is required to withhold on a withholdable payment).

"The revised W.P. and W.T. agreements replace the external audit requirement of the existing agreements with an internal compliance program."

Like the existing W.P. and W.T. agreements, the revised W.P. and W.T. agreements prohibit reliance on the presumption rules[50] with respect to direct partners, beneficiaries, or owners and retain an automatic termination provision for a W.P. or W.T.'s failure to obtain documentation for such direct partner, beneficiary, or owner. The revised agreements provide for the use of documentary evidence, in lieu of a Form W-8 or Form W-9, for direct partners, beneficiaries, or owners, provided that the W.P. or W.T. is an F.F.I. that is subject to the "know-your-customer" practices and procedures of a jurisdiction that the I.R.S. has approved.[51] The rules permitting the use of documentary evidence do not apply to an N.F.F.E. acting as a W.P. or W.T. Such W.P.'s or W.T.'s are required to obtain Forms W-8 and W-9 to document their partners, beneficiaries, or owners.

The revised W.P. and W.T. agreements replace the external audit requirement of the existing agreements with an internal compliance program. As part of the internal compliance program, a W.P. or W.T. is required to designate a responsible officer who will oversee the program and who will make a periodic certification of the W.P. or W.T. agreement and provide certain factual information regarding the results of the W.P. or W.T.'s internal compliance review. The factual information requested will vary depending on the reportable amounts received by the W.P. or W.T. and whether the W.P. or W.T. makes a pooled reporting election. A periodic certification will be required once every three calendar years that the agreement is

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50 The presumption rules generally apply to determine the status of a payee when the withholding agent cannot reliably associate the payment with valid documentation.

51 A list of approved jurisdictions can be found at: http://www.irs.gov/Businesses/International-Businesses/List-of-Approved-KYC-Rules.

in effect (including extensions). The W.P. or W.T. will be required to arrange for a periodic review of its compliance with the W.P. or W.T. agreement during the three-year certification period. However, the review report will not be required to be filed with the I.R.S. unless specifically requested.

The existing W.P. or W.T. agreements do not allow a W.P. or W.T. to act as a W.P. or W.T. for its indirect partners, beneficiaries, or owners, except in two specific situations, both of which require a written agreement between the W.P. or W.T. and another foreign partnership or foreign trust. The revised agreements require that a partnership or trust to which a W.P. or W.T. may apply the joint account or agency option must maintain a permissible Chapter 4 status. The agreements to apply the joint account or agency option are subject to special transitional rules.

The revised agreements permit a W.P. that meets certain conditions to either not file a partnership return or a Schedule K-1 for certain foreign partners, depending on whether the W.P. has any direct or indirect partners.

Modification of the agreement is possible by a rider only if the W.P. or W.T. has unique facts and circumstances that necessitate a modification. The I.R.S. may agree or refuse to modify the W.P. or W.T. agreements at its sole discretion. With respect to modifying the agreement to reduce the rate of withholding under Chapter 3, such modification does not require a rider and may be made if the W.P. or W.T. obtained a valid Form W-8BEN from a direct partner, beneficiary, or owner on which a claim of treaty benefits was made, including the appropriate limitation on benefits and Code §894 certifications, if applicable.

RENEWAL OF AGREEMENTS: EFFECTIVE DATES

A W.P. or W.T. that applied to renew its W.P. or W.T. status on the F.A.T.C.A registration website and that was approved by the I.R.S. on or before August 31, 2014 will have an agreement with effective date of June 30, 2014. A W.P. or W.T. that applies to renew its status on the F.A.T.C.A. registration website and is approved by the I.R.S. after August 31, 2014 will have the effective date of the date the renewal was approved. The date the renewal is approved is the later of the date the W.P. or W.T. is issued a G.I.I.N. or the date the W.P. or W.T. submits a request for renewal.

A W.P. that is an F.F.I. that is a retirement fund or an N.F.F.E. that is not a sponsoring entity that applied to renew its W.P. or W.T. agreement and the application was approved by the I.R.S. on or before August 31, 2014, will have an agreement with an effective date of June 30, 2014. A W.P. or W.T. that is a retirement fund or an N.F.F.E. that is not a sponsoring entity and that applied to renew its status after August 31, 2014 and that is approved by the I.R.S. will have an agreement with an effective date of the date of renewal as provided in the I.R.S.'s approval notice.

NEW AGREEMENTS: EFFECTIVE DATES

An entity that is an F.F.I. (other than a retirement fund) that applied for W.P. or W.T. status before August 31, 2014 and was approved will have an agreement with an effective date of June 30, 2014, provided that it obtains a G.I.I.N., if it has not already done so, within 90 days of such approval. An F.F.I. that applied after

August 31, 2014 will have an effective date of the date the entity is issued a W.P.-E.I.N. or W.T.-E.I.N., if its application is approved and provided that it obtains a G.I.I.N., if it has not already done so, within 90 days of such approval.

An entity that is a retirement fund or an N.F.F.E. that is not a sponsoring entity will have an agreement with an effective date of the date the entity is issued a W.P.-E.I.N. or W.T.-E.I.N., if its application is approved.

An entity that submitted an application for W.P. or W.T. status and that is approved by the I.R.S. during the 2014 calendar year may act as a W.P. or W.T. in accordance with the revised W.P. or W.T. agreements for the entire calendar year. With respect to amounts subject to Chapter 3 withholding received before June 30, 2014, the entity may act in accordance with the existing procedures as if the W.P. or W.T. agreement was effective on January 1, 2014 and expired on June 30, 2014. Amounts subject to Chapter 3 withholding received between June 30, 2014 and September 1, 2014 will be treated as in the transitional procedures mentioned below.

Applications for W.P. or W.T. status submitted in any calendar year after 2014, if approved, will be effective as of January 1 of the calendar year, if they are received on or before March 31 of that calendar year. Applications for W.P. or W.T. status received on or after April 1, if approved, will be effective as of January 1 of the following calendar year.

TRANSITIONAL PROCEDURES

An entity that received a withholdable payment under F.A.T.C.A., or an amount subject to Chapter 3 withholding, prior to September 1, 2014 may represent itself to its withholding agent as a W.P. or W.T., provided that the entity complies with the W.P. or W.T. agreement in effect prior to June 30, 2014 and, in the case of an existing W.P. or W.T., the entity has submitted a request for renewal on or before August 31, 2014. A W.P. or W.T. that makes a distribution for which withholding is required under F.A.T.C.A. beginning July 1, 2014 and does not withhold to the extent required under the revised agreements must make up the difference during the same calendar year.[52]

[52] The procedures that must be followed are similar to those that apply to under-withholding under Chapter 3. See Treas. Reg. §1.1474-2(b) and §1.1461-2(b).

CURRENT TAX COURT LITIGATION ILLUSTRATES INTANGIBLE PROPERTY TRANSFER PRICING AND VALUATION ISSUES

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Tags
Code §936(h)
Intangible Property
Medtronic
Possessions Corporation
Puerto Rico
Transfer Pricing
Zimmer

MOVING INTANGIBLE PPROPERTY ASSETS OVERSEAS PRESENTS BOTH BUSINESS AND TAX ISSUES

The movement of intangible property ("I.P.") offshore by U.S. multinational corporations has always been subject to high levels of I.R.S. scrutiny. This remains true in the current tax environment. It is a given that U.S. multinational companies are subject to a high level of U.S. corporate income tax at federal and state levels and their non-U.S. business operations are typically subject to lower tax rates abroad. As a result, U.S. multinationals can lower their global tax expense by transferring I.P. to an offshore subsidiary company ("I.P. Company"), when it is appropriate and consistent with the conduct of their international business operations.

In a typical arrangement within a group, the I.P. Company licenses the use of the I.P. to other members. Royalties paid by the other group members (including the U.S. parent, if total ownership of the I.P. is assumed by the I.P. Company) is claimed as a deduction in the tax jurisdictions of each member that is a licensee. If an I.P. Box Company arrangement is in place or a special ruling obtained, the royalties received by the I.P. Company will be subject to a low tax rate. Assuming that arrangements are in place to remove the royalty income from the category of Foreign Personal Holding Company Income for purposes of Subpart F, the net result is reduced tax for book and tax purposes. This yields greater profits for the multinational group and increased value for its shareholders.

Two cases that are currently in litigation illustrate the I.R.S. scrutiny given to transfers of I.P. to an I.P. Company and the resulting U.S. tax issues that are encountered. The cases involve Zimmer Holdings and Medtronic.

Both cases developed within the backdrop of I.R.S. scrutiny given to corporations that converted Code §936 operations to C.F.C.'s during the ten-year period after the repeal of Code §936. In its heyday, Code §936 complemented a local tax holiday program in Puerto Rico by providing a tax sparing foreign tax credit to U.S. companies categorized as possessions corporations in connection with possessions source income. The principal U.S. possession for this purpose was Puerto Rico. In 2007, the I.R.S. issued its Industry Directive on Section 936 Exit Strategies (the "936 Directive"), which sets forth its position regarding ancillary issues for transfers of possessions corporation businesses and assets to foreign affiliates. These issues included Code §§367(d) (relating to transfers of I.P. to a foreign entity in a tax-free transaction), 482 (relating to ongoing transfer pricing issues), and Subpart F (relating to issues involving C.F.C.'s that succeed to the business of the possessions corporation). The 936 Directive identified three types of issues that should be examined in a mandatory audit:

1. Whether the possessions corporation contributed any intangible property to the successor C.F.C. in connection with its conversion from a domestic U.S. corporation to a C.F.C. that should give rise to an imputed royalty under Code §367(d);

2. Whether the successor C.F.C. paid an arm's length royalty under a license or an arm’s buy-in royalty under a cost sharing agreement with respect to its acquisition of I.P. from the U.S. group member that owned the I.P. following the conversion to a C.F.C.; and

3. Whether the C.F.C.'s prices for products manufactured or for services rendered were arm's length under Code §482.

The 936 Directive instructs international examiners to test whether gains from any transfers of goodwill and going concern value qualify as foreign source income for foreign tax credit purposes and calls for arm’s length valuations of any goodwill or going concern value to the extent that these intangibles affect the C.F.C.'s subsequent pricing of its inventory and services.

With respect to Code §482, the I.R.S.’s international examiners were directed to limit income for most successor C.F.C.’s to a routine return with respect to the performance of manufacturing service functions. By doing so, all profits in excess of the routine return would be allocated back to the U.S. Use of a transfer pricing method for I.P., such as the foregone profits method, would accomplish this.

ZIMMER HOLDINGS

The first case involves Zimmer Holdings Inc., a U.S.-based manufacturer and seller of medical devices. In its Tax Court petition, it is challenging an I.R.S. assessment of additional tax in the amount of $79 million for tax years 2005 through 2007. A Dutch subsidiary of Zimmer succeeded to the legacy Puerto Rican manufacturing operations of the possessions corporation. Zimmer transferred ownership of I.P. to the Dutch subsidiary for use in conjunction with that company’s manufacture and sale of products. The Dutch subsidiary also licensed the same I.P. to Zimmer for use in U.S. operations.

The I.R.S. took three different approaches to assessing additional U.S. tax with respect to the transfer of I.P. to the Dutch subsidiary and the license back of the same I.P. from the Dutch subsidiary.

Transfer Pricing Adjustments

The primary basis for the I.R.S. assessment was the Code §482 transfer pricing rules. A transfer pricing adjustment of $108 million was proposed for 2006 and a second adjustment for $120.5 million in 2007. The I.R.S. asserted that the royalty payments claimed as deductions by the U.S. parent were in excess of an arm’s length rate. The I.R.S. asserted that Zimmer should have used the Comparable Profits Method ("C.P.M.") for determining the royalty amount.

The C.P.M., under Code §482, looks to an arm's length range of comparable profits determined by the appropriate profit level indicators, such as gross margin and operating margin. The range is based upon objective measures of profitability and is derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances. The indicators are applied to the taxpayer's financial data to determine a comparable operating profit. Whether an uncontrolled taxpayer will be treated as comparable depends on such factors as the relevant lines of business engaged in by the uncontrolled taxpayer and its functions, resources, and risks relative to those of the taxpayer.[53]

Zimmer's position is that the I.R.S.'s application of the C.P.M. was incorrect because the I.R.S. failed to recognize that the U.S. taxpayer was indemnified for all liabilities, claims, losses, and costs.

Toll Charge on Transfer of I.P. to Offshore Corporate Affiliate

Alternatively, the I.R.S. attacked the transfer of the I.P. from the U.S. group to a Dutch subsidiary in 2004. The I.R.S. position was based on Code §§367(d) and (a). Initially, the I.R.S. asserted that I.P. was transferred from a U.S. corporation to a non-U.S. related corporation in a transaction that was subject to Code §367(d). The rules of §367(d) apply only if intangible property is transferred by a U.S. person to a foreign corporation in a tax-free exchange described in Code §351 or Code §361. The term "intangible property" as used in Code §367(d) is defined by reference to Code §936(h)(3)(B), which provides that the following items constitute intangible property:

- A patent, invention, formula, process, design, pattern, or know-how;
- A copyright, literary, musical or artistic composition;
- A trademark, trade name or brand name;
- A franchise, license or contract;
- A method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data; and
- Any similar item.

Code §367(d) provides that the U.S. transferor is treated as having sold the intangible property in exchange for deemed annual payments that are contingent on the productivity, use, or disposition of the intangible property and that are commensurate with the income attributable to the intangible property. This means that each year the U.S. transferor must include in income amounts that represent an appropriate arm's length charge for the use of the intangible property, much like

[53] Treas. Reg. §1.482-5.

> *"Interestingly, the Code §367(d) adjustments asserted by the I.R.S. were greater than adjustments provided for under the Code §482 regulations."*

an annual royalty. The regulations state that the appropriate charge is determined in accordance with transfer pricing rules of Code §482. The taxable amounts are characterized as ordinary income of the U.S. transferor. Interestingly, the Code §367(d) adjustments asserted by the I.R.S. were greater than adjustments provided for under the Code §482 regulations.

Zimmer contended that it did not transfer I.P. to its foreign corporate affiliate, but rather it transferred tangible and other assets, so that Code §367(d) was not applicable. I.P. may have been developed later by the I.P. Company, but Zimmer asserted it was not originally transferred by the U.S. taxpayer. In essence, it argued that any transfer that may have taken place predated the creation of the I.P.

Transfer of Assets to Offshore Corporate Affiliate

The I.R.S. alternatively asserted that if no I.P. were transferred, then Code §367(a) applied, resulting in gain recognition in the year of the transfer. An exchange is within the scope of Code §367(a) if it is in connection with a "transfer" of "property" to a "foreign corporation." The I.R.S. asserted that this type of transfer occurred and that Code §367(a) overrides other nonrecognition rules, such as Code §351.

In response, Zimmer observed that Code §367(a) does not apply to tax a transfer if the transferred property is used in an active trade or business conducted outside the U.S. Zimmer claimed that it had transferred a real business operation with real employees, which was an active business and Code §367(a) did not apply.

Zimmer's petition was filed with the Tax Court on Aug. 13, 2014 and signals the start of what is likely to be a long and complex lawsuit.

MEDTRONIC

Medtronic is a U.S. multinational that has recently received press coverage for its pursuit of a possible inversion transaction with Covidian. The surviving entity in the corporate transaction is intended to be an Irish tax resident, resulting in group headquarters being moved to Ireland.[54]

Medtronic is embroiled in litigation challenging an I.R.S. deficiency which concluded that the company had underreported its taxable income by over $1 billion in 2005 and 2006. The basis of the I.R.S. position is the arm's length transfer pricing rules of Code §482. The I.R.S. applied those rules to the U.S. parent's license of I.P. to its Puerto Rican operating subsidiary.

The Medtronic tax litigation involves several transfer pricing issues related to Puerto Rican operations. The I.R.S. made adjustments to the royalty paid under the licenses of intangible property from Medtronic U.S. to its Puerto Rican manufacturers. According to the I.R.S., the royalty payments exceeded an arm's length amount. This was surprising because the I.R.S. and Medtronic signed a

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[54] Medtronic's Tax Inversion Lesson, Aug. 13, 2014 W.S. J. reproduced in, http://online.wsj.com/articles/medtronics-tax-lesson-1407883241.

memorandum of understanding relating to a 2000 to 2002 audit of the very same licensing arrangement. In reliance on that memorandum, Medtronic amended its 2003 and 2004 tax returns to incorporate the memorandum of understanding and then used it in preparing its 2005 and 2006 returns. Initially, the I.R.S. accepted the pricing methodology in the memorandum of understanding. However, the I.R.S. changed its audit team and made adjustments for the years 2005 and 2006 that effectively modified the methodology agreed upon in the memorandum of understanding. In response, the taxpayer took affirmative steps to use a methodology that predated the memorandum of understanding. Ultimately, adjustments were made by the I.R.S. for the years 2003 and 2004. As Medtronic found out, a change in the I.R.S. audit team can have terrible results as all agreements and understandings reached in prior years no longer have value.

"To prepare for potential I.R.S. audit issues, multinational groups may wish to consider use of a 'concept to customer' strategy regarding I.P."

While many of the issues faced by Medtronic differ from those encountered by Zimmer, it is undeniable that the issues of both taxpayers reflect the hardline approaches of the I.R.S. that are expressed in the 936 Directive for possessions corporations. It is likely not a coincidence that the I.R.S. moved away from the transfer pricing methodologies of the memorandum of understanding after the 936 Directive was issued.

CONCLUSION

The litigation issues facing Zimmer and Medtronic have arisen in the specific context of Code §936 conversions. Nonetheless, these cases illustrate the I.R.S. willingness to contest taxpayers' choices of the best method of transfer pricing. They reflect a reprise of the I.R.S. litigation position in the "contract manufacturing" and "round tripping" cases from the 1980's (*e.g.*, *Eli Lilly and Sundstrand*) under the framework of Code §§482 and 367.

To prepare for potential I.R.S. audit issues, multinational groups may wish to consider use of a "concept to customer" strategy regarding I.P. The strategy involves the following steps:

- Maintaining a robust inventory of I.P. used in the business;
- Knowing where the I.P. is being used and understanding how it generates business profits;
- Tracking I.P. development expenses on a contemporaneous basis, and allocating the expenses to specific projects and product line profitability accounts; and
- Recording on a management-team basis and on a legal-entity basis the specific entities that contribute to I.P. development and describing technically and in management terms the scope of those contributions.

I.R.S. ISSUES NEW FORM 1023-EZ: STREAMLINED EXEMPTION FOR SMALL CHARITIES

Author
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Tags
§501(c)(3)
1023-EZ
Charitable Organizations
Non-Profits
Tax-Exempt Status

On July 1, 2014, the Internal Revenue Service ("I.R.S.") introduced a new, shorter application form to help small public charities apply for recognition of tax-exempt status, under §501(c)(3) of the Internal Revenue Code ("the Code"), more easily.

Ruchelman P.L.L.C. used the new Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, for a client and received recognition of tax-exempt status in less than three weeks. Recognition of tax-exempt status ordinarily can take months, if not years (in the case of charities operating abroad). Prior to the introduction of Form 1023-EZ, expedited processing was available only under certain circumstances, generally in the case of a mass disaster (*e.g.*, terrorist attack, hurricane, etc.).

The new procedures may reduce the need for small charities to engage in fiscal sponsorships with larger public charities. Under a fiscal sponsorship, the larger charity agrees to sponsor the start-up charity, receiving and administering charitable contributions on behalf of the sponsored organization, for a fee.

The new Form 1023-EZ, is three pages long, compared with the standard 26-page Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. Most small organizations (which the I.R.S. estimates to be as many as 70% of all applicants) qualify to use the new streamlined form. Most organizations with gross receipts of $50,000 or less and assets of $250,000 or less are eligible. These are the same organizations that are eligible to file an "e-Postcard" annual return on Form 990-N.

The Form 1023-EZ must be filed using pay.gov (the secure electronic portal for making payments to Federal Government Agencies) and a $400 user fee is due at the time the form is submitted.

A charity must complete a worksheet[55] to determine eligibility to use the new streamlined procedure.

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[55] Form 1023-EZ Eligibility Worksheet is available under the *Instructions to Form 1023-EZ*, http://www.irs.gov/pub/irs-pdf/i1023ez.pdf.

A charity must be able to answer **NO** to each of the following questions:

4. Do you project that your annual gross receipts will exceed $50,000 in any of the next three years?

5. Have your annual gross receipts exceeded $50,000 in any of the past three years?

6. Do you have total assets in excess of $250,000?

7. Were you formed under the laws of a foreign country (United States territories and possessions are not considered foreign countries)?

8. Is your mailing address in a foreign country (United States territories and possessions are not considered foreign countries)?

9. Are you a successor to, or controlled by, an entity suspended under §501(p) (suspension of tax-exempt status of terrorist organizations)?

10. Are you a limited liability company ("L.L.C.")?

11. Are you a successor to a for-profit entity?

12. Were you previously revoked or are you a successor to a previously revoked organization (other than an organization the tax-exempt status of which was automatically revoked for failure to file a Form 990-series return for three consecutive years)?

13. Are you a church or a convention or association of churches described in §170(b)(1)(A)(i)?

14. Are you a school, college, or university described in §170(b)(1)(A)(ii)?

15. Are you a hospital or medical research organization described in §170(b)(1)(A)(iii) or a hospital organization described in §501(r)(2)(A)(i)?

16. Are you applying for exemption as a cooperative hospital service organization under §501(e)?

17. Are you applying for exemption as a cooperative service organization of operating educational organizations under §501(f)?

18. Are you applying for exemption as a qualified charitable risk pool under §501(n)?

19. Are you requesting classification as a supporting organization under §509(a)(3)?[56]

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56 Supporting organizations are organizations that have established certain relationships in support of other public charities.

20. Is a substantial purpose of your activities to provide assistance to individuals through credit counseling activities such as budgeting, personal finance, financial literacy, mortgage foreclosure assistance, or other consumer credit areas?

21. Do you or will you invest 5% or more of your total assets in securities or funds that are not publicly traded?

22. Do you participate, or intend to participate, in partnerships (including entities treated as partnerships for federal tax purposes) in which you share profits and losses with partners other than §501(c)(3) organizations?

23. Do you sell, or intend to sell carbon credits or carbon offsets?

24. Are you a Health Maintenance Organization ("HMO")?

25. Are you an Accountable Care Organization ("ACO"), or do you engage in or intend to engage in ACO activities?

26. Do you maintain or intend to maintain one or more donor advised funds?[57]

27. Are you organized and operated exclusively for testing for public safety and requesting a foundation classification under §509(a)(4)?

28. Are you requesting classification as a private operating foundation?[58]

29. Are you applying for retroactive reinstatement of exemption under §§5 or 6 of Rev. Proc. 2014-11, after being automatically revoked?[59]

If a charity qualifies for the streamlined procedure, other information is required to be furnished. In Part II of Form 1023-EZ, the charity must make certain attestations concerning the charity's organizational documents to ensure that there is compliance with §501(c) of the Code. Part III requires disclosures concerning the charity's specific activities. Part IV is designed to classify the organization as either a public charity or a private foundation, a determination which is generally dependent on the sources of the charity's funding.

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[57] A donor advised fund is a fund or account that is owned and controlled by the organization but that is separately identified by reference to contributions of a donor or donors and with respect to which a donor (or any person appointed or designated by the donor) has or expects to have advisory privileges concerning the distribution or investment of amounts held in the fund or account by reason of the donor's status as a donor.

[58] A private operating foundation actively conducts its own charitable, religious, educational, and similar activities (as opposed to indirectly carrying out these activities by providing grants to individuals or other organizations) but is not publicly supported.

[59] The streamlined process is not available if the application is later than fifteen months after the later of the date of the charity received its Revocation Letter or the date on which the I.R.S. posted the organization's name on the Revocation List.

Small charities must continue to be mindful of State registration requirements. New York State generally requires registration with the New York State Charities Bureau, although some exceptions apply (*e.g.*, religious organizations). A separate application must be made to New York State if a charity seeks a sales tax exemption.

The new procedures remove a very real and costly impediment for small start-up charities that seek tax-exempt status and will enable the I.R.S. to use its limited resources in a more effective manner.

CORPORATE INVERSION TRANSACTIONS: TAX PLANNING AS TREASON OR A CASE FOR REFORM?

Authors
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Tags
Corporate Tax
Inversion Transactions

INTRODUCTION

> Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury. There is not even a patriotic duty to increase one's taxes.
>
> – Judge Learned Hand
> *Helvering v. Gregory*, 69 F.2d 809, 810-11 (2d Cir. 1934).

To invert or not to invert: That seems to be the question many U.S. corporations are deliberating today, particularly in the context of acquisitions of non-U.S. businesses. Although the level of the political and public outcry on the "evils" of inversion transactions is a recent phenomenon, inversion transactions are not new to the U.S. business community. This article provides a perspective on the issue of U.S. companies incorporating in other jurisdictions by means of inversion transactions. It will discuss the historical context, the legislative and regulatory responses, and current events including proposed legislative developments as of the date of publication. Finally, we will offer our suggestions for a reasonable approach to the inversion issue designed to balance the governmental and the private sector concerns.

INVERSIONS: DEFINITION AND HISTORY

What is an Inversion?

An inversion transaction is a tax-motivated corporate restructuring of a U.S.-based multinational corporation or partnership in which the U.S. parent corporation or U.S. partnership is replaced by a foreign corporation, partnership, or other entity, thereby converting the U.S. entity into a foreign-based entity. In a "self-inversion," the U.S. entity effects an internal reorganization by re-domiciling in another jurisdiction. In an "acquisition-inversion," a U.S. entity migrates to a foreign jurisdiction in connection with the purchase of a foreign-incorporated M&A target corporation. In this latter type of inversion, the target and the U.S. entity often can be combined under a new holding company in a lower-tax foreign jurisdiction.

Stock Transaction/Asset Transaction

Inversion transactions take the form of stock or asset transactions.

In a stock transaction, shareholders of a publicly held U.S. corporation may exchange their shares for shares of a newly-created foreign subsidiary, incorporated in a tax haven such as Bermuda, in a stock-for-stock B-reorganization under Code §368 (a)(1)(B) or in a reverse subsidiary merger under Code §368 (a)(2)(E), with the U.S. parent surviving as a subsidiary of the foreign corporation. Foreign subsidiaries of the U.S. company would be transferred either before the transaction or as a post-transaction restructuring.

In an asset transaction, the U.S. company would transfer assets to the foreign corporation under Code §361(a) in return for shares of the foreign corporation's stock and the foreign corporation's assumption of the U.S. company's liabilities. The U.S. company would then transfer shares of the foreign corporation's stock to its shareholders in return for the shareholders' U.S. company stock, and the U.S. company's shareholders would exchange their U.S. company stock in return for the foreign corporation stock under Code §354(a).

History of Inversion Transactions

The first well-known inversion transaction was the McDermott International self-inversion to Panama in 1983, which prompted the 1984 enactment of Code §1248(i). Code §1248(i) imposes a §1248 tax, usually associated with sales of C.F.C.'s, to outbound transfers of stock in domestic U.S. companies where these transfers had the same substantive effect. Code §1248(i) creates a deemed distribution by the domestic corporation of the foreign stock received in the self-inversion, by treating the domestic corporation as having received and then distributed the stock of the foreign corporation that is received by the shareholders as part of the exchange. The deemed distribution is considered made in a redemption or liquidation of the domestic corporation, whichever is appropriate.

Changes to the U.S. Subpart F anti-deferral tax regime made by the Tax Reform Act of 1986 both expanded Subpart F and restricted use of foreign tax credits to offset U.S. tax on Subpart F income. As a result, U.S. multinational companies had legitimate concerns regarding double taxation of income resulting from restrictions placed on the foreign tax credit. From a U.S. corporate perspective, increased exposure of non-U.S. operations to the U.S. tax regime became a primary concern of management. U.S. companies analyzed and identified the benefits of an inversion transaction as:

- Removal of foreign subsidiaries from the U.S. Subpart F rules;
- Elimination of international double taxation caused by the interaction of the U.S. interest allocation rules and the U.S. foreign tax credit; and
- Increased flexibility in shifting risks and functions to more tax favorable environments.

Accordingly, some publicly held U.S. corporations acted on plans to transform to a subsidiary of an existing foreign subsidiary. Because of its new, *public* ownership, the former foreign subsidiary would not be a controlled foreign corporation.

The first such post 1986 Tax Reform Act stock inversion transaction was consummated in February of 1994 by Helen of Troy. Subsequent inversion transactions involved such companies as Stanley Works, Ingersoll-Rand, Tyco International, and Cooper Industries.

These transactions were primarily tax-driven and were publicized as such. The normal profile for an inversion company was a company with:

- Intellectual property that was under current or continuous development;
- Substantial foreign operations or with plans to effect substantial foreign acquisitions;
- Low-taxed foreign source earnings; and
- U.S.-sourced taxable income that could offset interest expense.

A company fitting this profile could see a dramatic decrease in its worldwide effective tax rate as a result of avoiding U.S. tax on low-tax foreign earnings and a reduction in U.S. tax from non-U.S. based financing of U.S. operations.

The post-inversion tax savings from an inversion transaction would generally be subjects to an upfront tax cost. The I.R.S. applied outbound taxation principles to the stock inversion transactions under Code §367(a). Under Code §367(a), gain, but not loss, is recognized on an outbound transfer of stock or assets except to the extent provided in regulations. However, corporations with sufficient tax attributes, such as net operating losses, could undertake inversion transactions without incremental U.S. tax cost. Alternatively, inversions could be structured to trigger shareholder level gain recognition in periods when the stock price was depressed, thereby minimizing the tax cost. Finally, "tax neutral" shareholders of U.S. companies, such as pension funds and tax-exempt entities, were ambivalent to any potential application of Code §367(a) outbound provisions.

The Treasury issued a special report on inversion transactions in May of 2002, ("the Report").[60] The Report was issued within the backdrop of an increase in inversion transactions subsequent to the fall in the stock market in 2001. The Report noted the increase in inversion transactions resulted in part from depressed market conditions that reduced exposure to upfront gain. The Report stated that the ability to realize substantial reduction in tax through a transaction that is complicated technically but virtually transparent operationally is cause for concern as a matter of tax policy.[61]

Pamela Olsen, the Acting Secretary of Treasury for Tax Policy at the time, testified before the House Ways and Means Committee on Inversions in June of 2002. She referenced the U.S. Treasury Report and made several proposals for tax legislation designed to address not only inversion transactions themselves, but the underlying defects in the U.S. international tax system that may have resulted in this form of

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[60] *Corporate Inversion Transactions-Tax Policy Implications*, Office of Tax Policy, Department of Treasury.

[61] The Report, p. 3.

corporate self-help. Most importantly, she cautioned against a "knee jerk" response to the inversion issue. She stated that:

> A narrow policy response to the inversion phenomenon may inadvertently result in a tax code favoring the acquisition of US operations by foreign corporations and the expansion of foreign controlled operations in the United States at the expense of domestically managed corporations. In turn, other decisions affecting the location of new investment, choice of suppliers, and employment opportunities may be adversely affected. While the openness of the US economy has always made – and will continue to make – the United States one of the most attractive and hospitable locations for foreign investment in the world, there is no merit in policies biased against domestic control and domestic management of US operations.[62]

Code §7874, effective for taxable years ending after March 4, 2003, was added by Section 801 of the American Jobs Creation Act of 2004. The legislative history of Code §7874 indicates that its basic thrust was inversion transactions in which a U.S. parent corporation of a multinational corporate group is replaced by a foreign entity while the existing shareholder group remains in control.[63]

In that regard, Congress specifically identified certain transactions that were to be subject to an ant-abuse rule. Thus, for example, a special rule was included for public offerings. Under the rule, the shares held by the public after the offering are disregarded in determining whether the ownership thresholds are met so that the anti-inversion rules apply. The Senate Finance Committee proposed a similar treatment for shareholders that invest in the foreign corporation as part of a private placement in which cash is invested.[64] However, this view was not incorporated in the final bill.[65] That position was rejected in conference when the legislation was adopted. It was not part of the House bill, and was not part of the bill that was adopted in the Senate-House Conference. The Statement of Managers to the Conference Report stated that the difference in the two bills was resolved when the House version prevailed. Although no reason was given for that result, there is no doubt that Congress rejected the Senate approach that all or most new cash investors had to be disregarded in determining the ownership thresholds for application of Code §7874.

However, Congress specifically included a broad grant of authority for the Treasury Department to issue regulations to attack avoidance schemes designed to circumvent the general rule Code §7874. These regulations were authorized to:

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62 Pamela Olsen, Acting Assistant Secretary to the Treasury (Tax Policy)- Statement before the House Ways and Means Committee on Inversions, June 6, 2002.

63 See H.R. Conf. Rep. No. 108755, 108th Cong., 2d Sess., at 568 (Oct. 7, 2004). These transactions were in effect those which were publicized and highlighted in the Treasury report and Ms. Olsen's testimony.

64 *Id*., at 571.

65 *Id*., at 573 et seq. The Conference committed followed the House version with Senate amendment with modifications.

> * * * prevent the avoidance of the purposes of the provision, including avoidance through the use of related persons, pass-through or other non-corporate entities, or other intermediaries, and through transactions designed to qualify or disqualify a person as a related person or a member of an expanded affiliated group. Similarly, the Treasury Secretary is granted authority to treat certain non-stock instruments as stock, and certain stock as not stock, where necessary to carry out the purposes of the provision.[66]

Congress also intended to address partnership transactions in addition to stock transaction. To that end Code §7874 was to apply to:

> * * * transactions in which a foreign-incorporated entity acquires substantially all of the properties constituting a trade or business of a domestic partnership, if after the acquisition at least 60 percent of the stock of the entity is held by former partners of the partnership (by reason of holding their partnership interests), provided that the other terms of the basic definition are met.[67]

Congress clarified that:

> For purposes of applying this test, all partnerships that are under common control within the meaning of Code § 482 are treated as one partnership, except as provided otherwise in regulations. In addition, the modified ''toll charge'' provisions apply at the partner level.[68]

LEGISLATIVE AND REGULATORY SCHEME

In General

The resulting legislative and regulatory scheme in the anti-inversion provisions of U.S. tax law, are meant to address perceived tax abuses resulting from the transfer the stock or assets of a U.S. business to an entity outside U.S. tax jurisdiction primarily for the benefit of shareholders or members. Where a transaction falls within the scope of these provisions, either the inverted U.S. entity will have to report the amount of inversion gain or the foreign entity will be characterized as a surrogate U.S. corporation.[69] A surrogate U.S. corporation is treated as if it were a U.S. domestic corporation and is taxed as such by the U.S. As an offset, the

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66 *Id.*, at 570.

67 *Id.*

68 *Id.*

69 Code §7874(d)(2) defines inversion gain in terms of income or gain resulting from the transfer of stock or assets abroad and related licensing income for a period of ten years after the transfer. This would essentially attribute all such licensing income from overseas business operations back to the U.S. regardless of how earned. Inversion gain of partnerships is reported at the partner level.

inversion gain is not taxed in the U.S. when the business or shares are transferred to a surrogate U.S. corporation.

The law provides that a foreign corporation is a surrogate U.S. corporation if the shareholders of the transferor U.S. corporation end up owning more than 80% of the stock of the foreign corporation by reason of their stock ownership of the domestic corporation whose stock or assets are acquired directly or indirectly by the foreign corporation at issue. Alternatively, it applies if substantially all of the business assets of a U.S. corporation are transferred to a foreign corporation and as a result, the 80% test is met. With respect to partnerships, the same result will apply if substantially all of the partnership's U.S. trade or business assets have been transferred to a foreign corporation and the U.S. partners hold 80% of the stock of the foreign corporation by reason of their partnership interests.

The anti-inversion rules apply if three basic conditions are satisfied:

- After March 4, 2003, the foreign corporation completes the direct or indirect acquisition of substantially all of the properties held by a domestic corporation;[70]

- After the acquisition, at least 60% of the stock by vote or value of the entity is held by former shareholders, partners or members of the domestic corporation by reason of holding stock or interests in the domestic corporation;[71] and

- After the acquisition the expanded affiliate group that includes the foreign corporation does not have substantial business activities in the foreign country in which, or under the law of which, the foreign corporation is created or organized, when compared to the total business activities of the expanded affiliated group.[72]

Stock of the foreign corporation held by members of the expanded affiliated group including the foreign corporation is disregarded in determining whether the vote and value condition is satisfied.[73] In addition, stock of the foreign corporation sold in a public offering related to the acquisition is disregarded for purposes of the ownership test.[74] Finally, the I.R.S. is granted broad authority to address abusive situations structured to avoid application of Code §7874.

An expatriated entity is a domestic corporation or partnership with respect to which a foreign corporation is a surrogate U.S. corporation. Also covered is any U.S. person related (within the meaning of Code §§267(b) or 707(b)(1)) to such domestic corporation or partnership.[75]

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70 Code §7874(a)(2)(B)(i)'s "acquisition condition."
71 Code §7874(a)(2)(B)(ii)(I)'s "vote and value condition."
72 Code §7874(a)(2)(B)(iii) "active trade or business condition."
73 Code §7874(c)(2)(A).
74 Code §7874(c)(2)(B).
75 Code §7874(a)(2)(A).

When the three conditions described above are met, a foreign corporation is treated as a surrogate U.S. corporation. Note that in applying the test related to business activities, the test is applied by reference to activities of the expanded affiliated group ("E.A.G.").[76] The E.A.G. is an affiliated group defined in Code §1504(a), but without regard to the exclusion of foreign corporations[77] and with a reduction of the 80% ownership threshold of Code §1504(a) to a more-than-50% ownership threshold.[78]

If only a 60% threshold of common ownership is achieved, the foreign corporation is referred to as a surrogate foreign corporation. The transfer of assets to the surrogate foreign corporation triggers gain, and subsequent fees for the license of intangible property by the surrogate foreign corporation are subject to U.S. tax. Neither the gain nor the licensing income can be reduced by net operating loss carryovers or foreign tax credits. This treatment applies from the first date properties are acquired pursuant to the plan through the end of the ten-year period following the completion of the acquisition.

Notice 2009-78

In Notice 2009-78, the I.R.S. expressed concern about transactions that escaped characterization as an inversion because of shares of stock issued to moneyed investors for cash or marketable securities. The I.R.S. became aware that investment banks and private equity firms could create a financial product by having clients join in an inversion transaction, contributing cash or marketable securities to the foreign entity and preventing the 80% threshold from being met. The securities or cash might be segregated to be available for redemption at an agreed upon time. Fees would be paid. To prevent that result, the I.R.S. announced that in regulations to be drafted which would be effective for transactions completed as of September 17, 2009 or later, shares of stock in a foreign corporation issued for cash or marketable securities would, subject to certain unnamed exceptions, be removed from consideration in determining whether the shareholders or members of the domestic entity own more than 80% of the foreign corporation to which substantially all of the assets are transferred.

On January 16, 2014, temporary regulations were issued as a follow up to Notice 2009-78. These regulations offer a new *de minimis* exception to allow some continued participation by former shareholders (or partners) of the U.S entity. For those who can qualify, the *de minimis* exception offers a previously unavailable option to allow some continuing involvement (up to 5%) by the former shareholders without triggering the inversion rules. This will allow a foreign corporate acquiror to acquire a U.S. corporation or U.S. partnership for cash consideration while allowing management or other shareholders to roll-over into an equity interest in the foreign corporate acquiror without having it deemed a U.S. corporation. The *de minimis* exclusion applies where:

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[76] Code §7874(a)(2)(B).
[77] Code §1504(b)(3)
[78] Code §7874(c)(1) .

- The ownership fraction determined without regard to the Exclusion Rule is less than 5% (by vote and value);

- After the acquisition and all transactions related to the acquisition, former shareholders of the U.S. corporation, in the aggregate, own directly or indirectly less than 5% (by vote and value) of the stock of any member of the expanded affiliated group that includes the foreign corporation; and

- Stock of the foreign corporation that would otherwise be excluded from the denominator of the ownership fraction was not transferred in a transaction related to the acquisition with a principal purpose of avoiding the purposes of Code §7874.

However, these regulations also expanded the scope of Notice 2009-78 by describing all situations in which stock will be excluded from the denominator of the ownership fraction and expanded the definition of nonqualified property for purposes of the exclusion rule to include certain obligations. To the extent such transfers increase the fair market value of the assets or decrease the amount of liabilities of the foreign corporation, regulations exclude the following from the ownership fraction:

- Stock of the foreign acquiror transferred to any person (including the U.S. corporation) in exchange for property to the extent, pursuant to the same plan (or series of related transactions), the stock is subsequently transferred in exchange for the satisfaction or the assumption of an obligation associated with the property exchanged; and

- Any stock of the foreign acquiror transferred in exchange for nonqualified property by any person (including an unrelated person) in connection with the potential inversion transaction.

These regulations are generally effective for transactions occurring on or after September 17, 2009 for matters addressed in Notice 2009-78, and on or after January 16, 2014 for matters not covered in Notice 2009-78 unless the taxpayer elects otherwise.

Temporary Regulations

On June 7, 2012, the I.R.S. issued temporary regulations[79] establishing a bright-line rule for the substantial business activities exception. An entity's expanded affiliated group will have substantial business activities in the foreign country of incorporation if the following tests are met regarding activities in the foreign country:

- 25% of the group's employees (by headcount and compensation during the twelve-month period preceding the inversion);

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[79] Reg. §1.7874-3T.

- 25% of the group’s active assets (tangible personal property and real property used or held in the active conduct of a trade or business; property the group rents is assigned a value equal to eight times its annual rent); and

- 25% of the group’s gross income from unrelated customers and received in the ordinary course of business.

Under the temporary regulations, if one or more members of the expanded affiliated group hold, in the aggregate, more than 50% (by value) of the interests in a partnership, that partnership’s items shall be taken into account in these calculations. Other U.S. tax rules, such as Code §367, net operating loss, and foreign tax credit carryover suspensions, continue to apply.

CURRENT EVENTS

Political and business news regarding inversion transactions is almost a daily occurrence. The more significant recent developments are summarized below.

Congressional Action

There is a growing Congressional frustration with large U.S. companies partaking in inversion transactions, but it remains unclear when lawmakers will act to prevent these deals or diminish their tax benefits.

Six House and Senate Democrats called on the Obama administration to deny federal contracts to companies that have moved their headquarters offshore for tax purposes. A letter to President Obama, signed by Reps. Rosa DeLauro (D-Conn.), Lloyd Doggett (D-Texas), and Sander Levin (D-Mich.), and Sens. Carl Levin (D-Mich.), Dick Durbin (D-Ill.) and Jack Reed (D-R.I.), said that companies enjoy the infrastructure provided by U.S. taxes, but manage to avoid contributing their share toward paying for them. They say, “When the tax bill comes due, they renounce their citizenship. But, perhaps even more outrageously, they also seek, and win, taxpayer-funded federal contracts from the same country they renounced.” The lawmakers expressed support for the No Federal Contracts for Corporate Deserters Act (H.R. 5278, S. 2704), legislation that was introduced on July 30, that would tighten restrictions on corporate inversions. Those bills remain in committee.

On August 14, Senator Charles E. Schumer (D-N.Y.) offered a proposal to curb earnings stripping. Schumer said in a news release, “We cannot stand idly by while corporate deserters abuse and avoid the U.S. tax system.” The Schumer proposal was introduced formally as an anti-inversion bill on September 10, 2014. The proposal includes:

- Repealing the debt-to-equity safe harbor such that limitations on the interest deduction apply to all inverted corporations, regardless of financial leverage;

- Reducing the allowed net interest expense from 50% to no more than 25% of the subsidiary’s adjusted income;

- Repealing the interest expense deduction carry-forward and excess limitation carry-forward such that inverters would be unable to take advantage of the deduction in the future; and

- Requiring the U.S. subsidiary to obtain yearly preapproval from the I.R.S. on the terms of its related-party transactions for ten years immediately following an inversion.

Similar proposals have been introduced by other members of the House and Senate, including tightening the existing anti-inversion regime under Code §7874 (the earnings-stripping rules) and tightening exceptions to Subpart F rules

Executive Branch Considerations

"While most of the discussion on executive action has focused on earnings stripping, other possible avenues have been considered, including the possibility of attacking fact patterns where 'substantial business operations' do not exist in the country of tax residence."

While most of the discussion on executive action has focused on earnings stripping, other possible avenues have been considered, including the possibility of attacking fact patterns where "substantial business operations" do not exist in the country of tax residence. This approach will not address an inversion that is part of an M&A transaction, which covers the majority of the most recent inversion transactions. These inversions typically have less than 60% of the former U.S. parent's shareholders as owners of the new company and also have substantial activities in the country of tax residence.

President Obama has announced consideration of a plan to bypass Congress and act on corporate inversions unilaterally. Stephen Shay, currently a professor of tax law at Harvard Law School and previously a Treasury Department official, has stated that the Administration could use Code §385 as a way to curb the earnings stripping that often accompanies corporate inversions. Code §385 gives the Treasury the power to designate an instrument issued by a corporation as debt or equity. Other tax experts are skeptical of this approach, believing that Code §385. Originally, the long-standing law was passed to deal with tax issues arising from domestic corporate mergers and has never been viewed as a means to fight base erosion. Still, others have suggested that the Administration could rely on older law to enact restrictions that are harsher than the earnings stripping rules.

The Business Community

Beginning in 2012, 21 U.S. companies have announced or completed inversion transactions of one kind or another, representing almost half of the 51 total such transactions in the last three decades.

One embarrassing episode for the Administration is that in 2009, when the Treasury Department bailed out the auto industry, Delphi Corp. emerge from bankruptcy as a U.K. company rather than a U.S. company. The Administration and Delphi are at odds as to whether that was intended.

On July 24, President Obama referred to companies looking to shift domicile to other countries as corporate deserters. Since then, Burger King Worldwide Inc. announced the acquisition of Tim Horton's Inc., a Canadian corporation, and a plan to establish its headquarters in Canada, where taxes are generally lower than in the U.S. on direct investment dividends.

Some announced inversion plans contain an escape provision that allows cancellation of the deal if a law is implemented that would mean the new company would be treated as a U.S. domestic corporation for tax purposes. An example is Medtronic's agreement to buy Covidien Plc, an Irish domiciled company. Medtronic has maintained that the main purpose for the deal is strategic. It will combine the two companies' complementary product lines and will free up cash generated overseas for reinvestment in the United States. Medtronic announced its expectation to invest more aggressively in the United States after the deal closes.

Other rumored potential inversions have seemingly been put on hold to see what emerges from the political debate. This most notably includes Walgreens Co., the largest U.S. drugstore, which passed on an opportunity to move its domicile to Switzerland when it bought Alliance Boots GmbH.

Avoiding Inversions

Although lawmakers are trying to determine ways to stop the inversions, there are other ways to avoid taxes by claiming a foreign address. Private equity buyout deals would be much tougher to regulate due to the fact that they involve U.S. companies that are technically sold to a foreign buyer.

At least 14 companies have left the U.S. tax system through a sale to an investment fund. In these transactions, top executives remain based in the U.S., but the companies are incorporated offshore. Companies that have used this strategy include Michael Kors Holdings, Ltd., which is now incorporated in the British Virgin Islands, and Herbalife Ltd, which operates from Los Angeles but is incorporated in the Cayman Islands. Dell Inc. considered the idea of incorporating in a foreign country, but in the end opted to remain registered in the U.S.

Rep. Sander Levin (D-Mich.) has proposed a rule that would treat certain companies as domestic after a sale to a foreign buyer if the combined company's "management and control" remain in the U.S. This rule may affect companies that undergo future buyouts. This, however, may create a different problem. Companies may move their top executives abroad as part of a leveraged buyout, taking high paying jobs as well as tax revenue out of the county.

CONCLUSION AND RECOMMEDATIONS

Inversions have been a significant catalyst in cross-border M&A activity in recent years. Consistent with the original profile of stock inversion transactions noted above, many transactions have been concentrated in industries having business models that involve offshore transfers of I.P. tailored for non-U.S. commercial markets and where gross revenues from outside the U.S. are material. The pharmaceutical industry is currently a source of many of the inversion transactions based on this profile (*e.g.*, Actavis/Warner Chilcott, Endo/Paladin, and Perrigo/Elan).

In addition, already-completed inversions can be drivers of further M&A opportunities – either by positioning the inverted company as an advantaged potential acquirer of future targets (*e.g.*, Actavis/Forest Labs) or perhaps by making the now-enlarged inverted company a target for an even larger U.S. company seeking yet another inversion.

Inversion transactions have positioned themselves at the heart of the debate on how the U.S. can tax foreign profits. Republicans advocate a new tax holiday, while the Obama administration fiercely opposes the concept, proposing instead to tax foreign profits even when not repatriated. As of the writing of this article, some type of anti-inversion legislation seems to be gaining traction in the current Congress. Whether such legislation can avoid any long-term negative economic effects, however, remains to be seen. The fact of the matter is that many U.S. companies' growth is increasingly generated abroad.

Accordingly, if enacted solely as a punitive measure, U.S. tax policy with respect to inversion transactions would only incentivize investment abroad or hoarding foreign earnings in low-tax countries. This would exacerbate the problems caused by the existing U.S. tax Code's complexity and, as argued by many, create bias against international businesses. The authors recommend consideration of one of the following approaches to the inversion issue:

1. Reprise Code §965 with some safeguards to guarantee proper U.S.-based investment.

Code §965 provided for a one-year dividend repatriation tax holiday. It allowed a U.S. corporate shareholder ("U.S.S.") to elect, for one tax year, to receive an 85% dividends received deduction ("D.R.D.") on qualifying dividends received from its C.F.C.'s. That allowance would generally reduce the effective tax rate on repatriated earnings to 5.25%. Qualifying dividends, as described in Code §965, were initially subject to four principal limitations (later clarified in three notices from the I.R.S.):

- Code §965(b)(1) capped the amount of the dividends eligible to the greater of $500 million or "the amount shown on the applicable financial statements as permanently invested outside the U.S."

- Code §965(b)(2) limited the D.R.D. to "extraordinary" cash dividends: those demonstrated to be in excess of the average dividends paid to the U.S. corporation by the C.F.C. Thus, only dividends that exceeded a base period amount found by taking the average of dividends and other distributions during the five years ending on June 30, 2003 could qualify. Of course, if the base amount were zero because all earning were permanently invested overseas, the base would be meaningless.

- Code §965(b)(3) reduced the amount of the eligible dividends by any increase in related-party debt. In effect, the C.F.C. was required to borrow from unrelated parties, liquidate cash equivalent securities, or use cash on hand to pay the extraordinary dividend. The U.S.S. could not borrow to fund the dividend of its foreign subsidiaries.

- Code §965(b)(4) created the most controversial and flexible limitation in the dividends qualifying for the D.R.D. This stipulation required that the U.S.S. claiming the D.R.D. invest the full amount of the dividend in the United States, in accordance with a domestic reinvestment plan ("D.R.I.P.") adopted before the payment or the dividend. The D.R.I.P. was required to be approved by the management of the U.S.S., including the C.E.O. and the board of directors, making it subject to Sarbanes-Oxley requirements. However, as a practical matter, no incremental investment requirement was imposed under the limitation. Specifically, the U.S.S. could use the funds for any qualifying investment without having to demonstrate that the amount spent on that investment exceeded either: (i) the average amount spent in previous years or (ii) the amount of spending budgeted before receiving the dividend.

Of the roughly 9,700 companies that had C.F.C.'s in 2004, 843 corporations took advantage of Code §965, repatriating $362 billion, of which $312 billion was eligible for deduction. The stated goal of Code §965 was to provide economic stimulus in the United States and to promote the creation of new jobs. Congressional representatives from both parties made the case for the bill based on the jobs that would be created with new cash investments by domestic companies.

If Code §965 were reinstated on a permanent basis and tighter rules and controls were implemented with respect to U.S. investment, the resulting stimulation of growth and investment among participating companies and job creation could well provide an appropriate measure of success.

Several caveats should be considered in connection with this proposal.

- The rules should be drafted to encourage U.S. companies of all sizes to participate, not just the large multinationals who participated in 2004.

- Attractive U.S. investment opportunities must be identified and nurtured. These opportunities must be over and above the dividend received tax break itself, and be attractive to industries whose business models (as noted above) are international in nature. These opportunities could take the form of research and development, investment tax credits, industry-related tax benefits incentives for domestic acquisition, or M&A transactions, among others. In this regard, it is noted that most of the repatriated funds in 2004 were in fact used for share repurchase programs by the participating companies.

- Avoid early (or any) sun-setting of the provision. It was shown in 2004 that the one-year period encouraged "one off" repatriations, as opposed to repatriations which would be integrated in a U.S. company's ongoing strategic financial or business plan.

- Don't get trapped in accounting rules. The 2004 statute keyed into "permanently reinvested earnings." Any new legislation should provide for whatever cash can be repatriated on the assumption that the cash infusion to the U.S. will have the intended growth and economic stimulation effects.

2. Revision of U.S. Taxation of Foreign Earnings on a Permanent Basis

As an alternative or complement to a Code §965 approach, enacting a near-term cash tax repatriation strategy as a precursor to longer-term reforms should be considered. This regime would create a separate, internationally competitive tax rate on foreign earnings, with a view to leading to greater value creation for shareholders, smarter investment by firms, and a new source of revenue for the federal government.

The worldwide U.S. tax regime with foreign tax credit offset along with the Subpart F regime could be replaced. Under this current regime, contrary to the arguments that the playing field is not level for “domestic” versus “international” companies, it is the international companies that are more likely to be subject to the higher tax burden. The fact that the U.S. has the highest corporate statutory rate in the world only adds insult to injury.

For example, if the shareholder of a U.S. entity is a corporation, Code §243 states that some form of dividend received deduction could be taken if the dividend recipient owns at least 10% of the distributing entity. The deduction could be up to 100% of the dividend received if the corporation owns at least 80% of the subsidiary's stock.

Contrast this with dividends received from a foreign subsidiary. In the latter situation, Code §902 states that the U.S. parent reports the entire pre-tax distributed amount and pays U.S. corporate income taxes on that amount, offset by whatever taxes were already paid to the foreign government. If Subpart F applies, U.S. tax is imposed without cash flow to the shareholder.

Imposing a dividends received deduction for dividends from abroad would in fact level the playing field for international and domestic based U.S. Companies. The dividends received deduction could be tied to a double tiered tax credit system. Code §243 et seq. rules could apply to foreign-sourced dividend income, with the added possibility of tax credits for dividend taxes paid on funds designed for U.S. reinvestment.

Given the current skepticism of U.S. multinational company tax affairs, any plan designed and implemented must be closely monitored. This would be done with a view towards quantifying whether the lower effective tax rate on foreign-sourced earnings repatriated and reinvested is enough to close the gap between the advantages that foreign investments enjoy relative to those in the United States. This analysis could provide source data for or against further U.S. tax reform, such as a territorial system. Increased cash flow to the U.S. would in fact present itself in other business transactions which themselves generate tax revenue. Examples include increased taxable wages, goods and services transactions subject to sales taxes, paying taxable dividends to shareholders, and increasing the value of corporate shares owned by taxable U.S. investors. Note, in this regard, that corporate tax revenues per se have never been a major component of the U.S. Treasury tax revenue stream.

Inversion transactions may slow down in light of proposed legislation, but the factors that motivate these transactions remain. Dealing with these issues is like the old time health remedy, castor oil. The taste may not be great, but one was a better person for having swallowed the medicine. It is time for the stakeholders, government, public, and business communities of the U.S. to ready the teaspoon.

CORPORATE MATTERS:
DELAWARE OR NEW YORK L.L.C.?

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Tags
Delaware
New York
Foreign L.L.C.
L.L.C.

When a client is considering commencing business operations in New York, we are often asked whether it is preferable to form a limited liability company ("L.L.C.") in New York or in Delaware. As we have mentioned in a previous issues,[80] Delaware is generally the preferred jurisdiction for incorporation and the jurisdiction we typically recommend.

We thought it might be helpful to set out a short summary of issues that one will encounter in choosing between a New York or a Delaware L.L.C. and the relevant advantages and disadvantages of using either state.

Filing Fees

The fee for filing the articles of organization for a New York L.L.C. is $200,[81] while the fee for filing a certificate of formation in Delaware is only $90.00.[82] However, if the Delaware L.L.C. intends to conduct business in New York, it must file an application of authority for a foreign limited liability company, accompanied with a certificate of good standing from Delaware.

The determination of whether the Delaware L.L.C. is conducting business in New York is largely fact specific.[83] The filing fee for the application for authority is $250,[84] and the Delaware fee for a certificate of good standing can range from $50 (for a short form certificate) to $175 (for a long form certificate).[85]

New York Publication Requirements

Within 120 days after its articles of organization become effective (in the case of a New York L.L.C.) or filing as a foreign entity (in the case of a Delaware L.L.C.), the L.L.C. must publish a copy of the articles of organization (or a notice related to the formation of the L.L.C.) or application for authority (or a notice related to the qualification of the L.L.C.) for eight weeks in two separate newspapers located within the county in which the L.L.C. is located. The affidavits of publication,

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80 Insights Volume 1 No. 2; Insights Volume 1 No. 5
81 N.Y.L.L.C.L. §1101(f) (Consol. 2014).
82 6 Del. C. §18-1105(a)(3).
83 "Doing Business in New York, An Introduction to Qualification," Department of State, General Counsel, February 2000.
84 N.Y.L.L.C.L. §1101(k) (Consol. 2014).
85 6 Del. C. §18-1105(a)(10).

certificate of publication form, and filing fee must be filed with the New York Department of State.

Accounting Fees/Tax Filings

A Delaware L.L.C. is not required to file an annual report but is required to pay an annual franchise tax. Taxes are to be received no later than June 1 of each year. The franchise tax is a flat rate of $300.00. Failure to pay the tax by June 1 results in an additional $200 penalty, plus interest on the tax and the penalty at a rate of 1.5% per month, and loss of the entity's good standing status.[86]

A Delaware L.L.C. conducting business in New York (or a New York L.L.C.) must pay an annual filing fee to New York State using Form IT-204-LL.[87] The amount of the filing fee will be based on the total of the New York-source gross income for the tax year immediately preceding the tax year for which the fee is due. If an L.L.C. did not have any New York-source gross income for the preceding tax year, the filing fee will be $25. Form IT-204-LL must be filed within 60 days of the last day of the L.L.C.'s tax year. There is no extension of time allowed to file Form IT-204-LL or for payment of the fee.

The filing fee in New York is based on a progressive rate as follows:

N.Y.-source gross income of an L.L.C. or L.L.P.		**Filing fee:**
Greater than:	**Not exceeding:**	
$0	$100,000	$25
$100,000	$250,000	$50
$250,000	$500,000	$175
$500,000	1,000,000	$500
$1,000,000	$5,000,000	$1,500
$5,000,000	$25,000,000	$3,000
$25,000,000	N/A	$4,500

Statutory Representation/Registered Agent in Delaware

Delaware law requires that an L.L.C. have and maintain a registered agent in Delaware who may be either an individual resident or a business entity that is authorized to conduct business in Delaware. The registered agent must have a physical street address in Delaware. If the business is physically located in Delaware, then the business may act as its own registered agent.[88]

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86 6 Del. C. §18-1107.

87 "Instructions for Form IT-204-LL," New York State Department of Taxation and Finance; "Form IT-204-LL."

88 6 Del. C. §18-104(a)

Consequently, the fee for a registered agent in Delaware will represent an additional annual cost.

In New York, the secretary of state must be designated as agent for service of process. New York does not require a third-party registered agent.[89]

Fiduciary Duty

Delaware expressly permits the restriction or elimination of fiduciary duties with the exception of the duty of good faith and the duty of fair dealing. Consequently, a member, or manager, may be personally liable for violating the above two duties.[90]

Likewise, in New York, an operating agreement may limit or even eliminate the personal liability of managers or members. However, the New York operating agreement cannot limit or eliminate the liability of a manager who acts in bad faith, is involved in intentional misconduct, has knowledge of a violation of the law or has gained a financial profit to which he or she was not legally entitled.[91]

Necessity of Operating Agreement

New York requires a written operating agreement (limited liability company agreement) within 90 days of the entity's formation. Members are required to be signatories to the operating agreement, but there is no requirement that the L.L.C. itself be a party to the agreement.[92] On the other hand, Delaware specifically provides that an L.L.C. is bound by its limited liability company agreement whether or not the L.L.C. executes the agreement.[93] While Delaware does not require one, we nevertheless generally recommend a written operating agreement (limited liability company agreement) for Delaware L.L.C.'s.

Management by Managers

In both New York and Delaware, unless management authority of an L.L.C. is given to a manager, management of the L.L.C. will be by the members. Management authority can be designated to a manager either at formation or possibly through an amendment at a later point in time.[94]

Removal of Managers

In Delaware, a manager is typically removed pursuant to the terms of the limited liability company agreement.[95] A manager can also be removed through a decision by the Delaware Court of Chancery. A manager may also resign at any time upon notice to the members and other managers. An L.L.C. may recover damages if the

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89 N.Y.L.L.C.L. §§203 (e)(4), (e)(5) (Consol. 2014).
90 6 Del. C. §18-1101(c), (e).
91 N.Y.L.L.C.L. §417(a) (Consol. 2014).
92 N.Y.L.L.C.L. §417(c) (Consol. 2014).
93 6 Del. C §18-101(7).
94 N.Y.L.L.C.L. §401(a).
95 6 Del. C. §18-402, 6 Del. C. §18-110(a).

“Delaware permits a merger of an L.L.C. without a vote of members if expressly provided in the L.L.C. Agreement… In New York, an operating agreement may change the percentage required for a merger approval.”

resignation contravenes the L.L.C. agreement.[96] In New York, managers can be removed with or without cause by a vote of a majority of the members entitled to vote. However, this rule may be changed by a provision in the operating agreement.[97] As in the case of a Delaware L.L.C., a manager may resign, although the L.L.C. may recover damages.[98]

Merger

Delaware permits a merger of an L.L.C. without a vote of members if expressly provided in the L.L.C. Agreement.[99] If not stipulated in the agreement, then a merger is permitted if approved by members owning more than 50% of the ownership percentage (or other ownership interest) of the L.L.C. In New York, an operating agreement may change the percentage required for a merger approval, but this percentage cannot be less than a majority in interest who are entitled to vote.[100]

Indemnification

Both New York and Delaware allow indemnification of any member or manager or other person from and against any and all claims, consistent with their respective statutes.[101]

CONCLUSION

The choice between forming a New York L.L.C. versus a Delaware L.L.C. for a New York business will depend on the particular facts and circumstances of the client. While Delaware may prove to be the more expensive choice (unless the New York publication requirements are found to be inapplicable), Delaware’s L.L.C. law is more frequently updated and may prove to be more manager-friendly.

96 6 Del. C. §18-602.
97 N.Y.L.L.C.L. §414 (Consol. 2014).
98 N.Y.L.L.C.L. §415 (Consol. 2014).
99 6 Del. C. §18-209(b).
100 N.Y.L.L.C.L. §1002(c) (Consol. 2014).
101 N.Y.L.L.C.L. §420 (Consol. 2014); 6 Del.C.§18-108.

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Tag
F.A.T.C.A.

ISRAEL IS BECOMING THE I.R.S.'S STRICTEST ENFORCER OF F.A.T.C.A.

On May 4, 2014 Israel reached a Model 1 agreement with the U.S. Israel has shown a strong eagerness to accept F.A.T.C.A. In 2012, the Association of Banks in Israel urged the country's central bank, the Bank of Israel, to ask the government to reach a F.A.T.C.A. agreement with the United States. Earlier in 2014, even before the signing of the F.A.T.C.A. agreement, the Bank of Israel ordered Israeli financial institutions to begin to implement F.A.T.C.A. procedures, including appointing an officer to oversee F.A.T.C.A. compliance, identifying U.S. customers, making them sign I.R.S. declarations (such as I.R.S. Form W-9 or Form W-8BEN), and expelling any clients unwilling to do so. Israel has shown strong support and an eagerness to uphold the enforcement of F.A.T.C.A.

The Israeli Ministry of Finance has drafted proposed regulations that would impose criminal penalties on Israeli financial institutions (including banks, brokerage houses, and insurance companies) that do not comply with F.A.T.C.A. reporting obligations.

CANADIANS CHALLENGE F.A.T.C.A. AGREEMENT

On August 11, through the Alliance for the Defense of Canadian Sovereignty, two U.S.-born Canadians filed a lawsuit against the Canadian government asserting that the Canadian I.G.A. was unconstitutional.

A statement of claim at the Federal Court of Canada in Vancouver was filed against the defendant, the Attorney General of Canada, contesting the Model 1 reciprocal I.G.A. that Canada and the United States signed on February 5.

In the filing, the plaintiffs alleged that Annex 1 of the Canada-U.S. I.G.A., which sets out due diligence procedures for Canadian financial institutions, and Part XVIII of the Income Tax Act, which requires Canadian financial institutions to undertake due diligence procedures, do not apply to provincially regulated financial institutions on the basis of §§92(13) and 92(16) of the Constitution Act of 1867.

Specifically, the claim asserts that the I.G.A. is inconsistent with the provisions of the unwritten principles of the Constitution, in particular to Canada not giving up its sovereignty to a foreign state. Also, the plaintiffs argued that the provisions violated §§7, 8, and 15 of the Canadian Charter of Rights and Freedoms concerning rights to liberty and security, rights to security against unreasonable search and seizure, and rights to the equal protection and equal benefit of the law without discrimination.

Apart from the invalidity of the I.G.A., the claim does not directly challenge F.A.T.C.A.'s application to the Canadian financial institutions. As a result, if the claim should succeed, the Canadian financial institutions will still have to comply with F.A.T.C.A. for elimination of the potential F.A.T.C.A. withholding tax, but without the benefit of the I.G.A.

"Obligations and penalties that foreign governments may impose to implement F.A.T.C.A. could create stricter compliance obligations than F.A.T.C.A. itself does."

PRE-EXISTING TREATMENT FOR OBLIGATIONS OF INTERMEDIARIES, FLOW-THROUGH ENTITIES

As of August 11, withholding agents can treat obligations held by intermediaries and flow-through entities as pre-existing under F.A.T.C.A. until the end of the year. The update was made to the frequently asked questions in an answer stating that if they are issued, opened, or executed before January 1, 2015, withholding agents may rely on pre-F.A.T.C.A. Form W-8's to document the holder of the obligations.

FOREIGN F.A.T.C.A. REQUIREMENTS MAY BE MORE STRINGENT THAN F.A.T.C.A. ITSELF

The I.G.A.'s signed by each nation have differences stemming from specific laws and types of financial institutions in the various jurisdictions. Obligations and penalties that foreign governments may impose to implement F.A.T.C.A. could create stricter compliance obligations than F.A.T.C.A. itself does.

France has implemented a domestic law that would levy a small per-account fine on institutions deemed non-compliant with F.A.T.C.A. reporting obligations. Specifically, France has already inserted an article into its tax code to address F.A.T.C.A. The new provision imposes a fine of €200 ($265) per customer for institutions failing to report F.A.T.C.A. information to the French tax authority. Additionally, jurisdictions are free to impose a stricter standard, such as requiring reporting of accounts under $50,000 or setting tighter deadlines.

SIGNIFICANT I.G.A. COUNTRIES ADDED

On August 8, after a long protracted time period, Sweden has finally signed a Model 1 I.G.A. Subsequent modifications of the Swedish law were made public on August 11 in a proposal to the Ministry of Finance. The legal changes to implement the treaty are expected to go into effect by April 1, 2015.

On August 12, Italy's parliament broke for its summer recess without ratifying the agreement necessary for F.A.T.C.A. to enter into force, and it was not clear when the measure would be taken up when lawmakers return in September.

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

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

The countries that are Model II partners are: Armenia, Austria, Bermuda, Chile, Hong Kong, Iraq, Japan, Moldova, Nicaragua, Paraguay, San Marino, Switzerland, and Taiwan.

This list is expected to continue to grow.

THE U.S.–SWEDEN I.G.A.: A PRACTITIONER'S PERSPECTIVE

Authors
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Tags
F.A.T.C.A.
Sweden

Sweden recently entered into an intergovernmental agreement ("I.G.A.") with the U.S. to address the application of F.A.T.C.A. to Swedish financial institutions. The subsequent modifications to Swedish law to accommodate the I.G.A. were made public on August 11, 2014 in a proposal by the Ministry of Finance.[102] The proposal added numerous modifications to the requirements for compliance and published the reporting forms that will be due starting next year. The complexity of F.A.T.C.A. compliance will trigger a number of changes in many areas of Swedish legislation, which are likely to be approved by the Swedish Parliament in the fall of 2014. It is clear that F.A.T.C.A. will make life more complex for the regulated groups.

F.A.T.C.A. will have a broad, sweeping effect on Swedish financial institutions ("F.I.'s"), including large Swedish banks, insurance companies, and private equity companies. These F.I.'s have been planning for F.A.T.C.A. and have implemented technology, procedures, and training that have caused them to incur in significant costs. However, based on personal experience, it appears that there is a large group of "institutions" that do not understand that they are in fact F.I.'s and must act accordingly. Recently, when discussing due diligence procedures mandated by F.A.T.C.A. with management of a Swedish permanent establishment, the response was simply "thanks for the heads up," which indicated that the compliance requirements were not yet on the company's radar.

Some of these institutions may revert to the simplest solution – barring Americans from being accepted as investors or account holders. This solution, however, is suboptimal for an F.I. as it eliminates a large group of Swedish/U.S. dual citizens from the client base. Of greater importance is the fact that barring Americans does not mean an institution can ignore F.A.T.C.A. F.A.T.C.A. requires disclosure of U.S.-controlled foreign entities that may be account holders at these institutions, a task that will require creating new on-boarding procedures and a review of all pre-existing accounts.

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The Swedish I.G.A. is a Model 1 I.G.A. that will require Swedish Reporting Financial Institutions ("R.F.I.'s") to provide F.A.T.C.A. reporting directly to the Swedish Tax Authorities, which may streamline the implementation process and greatly ease compliance for officers and practitioners. Having the Swedish

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[102] Fi2014/2687.

government act as an intermediary for the information flow to the I.R.S. may help ease concerns of Swedish institutions that face confidentiality issues under existing Swedish law and practice. For most entities, the main issue will be navigating compliance and determining how to develop due diligence processes that are "sufficient" in the context of F.A.T.C.A.

The I.G.A. excludes a number of potential reporting obligations by adding exceptions. For example, pension plans can easily be caught within the scope of F.I.'s, but Annex II to the I.G.A. adds exceptions for Treaty-Qualified Retirement Funds, Broad Participation Retirement Funds, Narrow Participation Retirement Funds, and certain other funds that should ease the concerns of many Swedish pension plans. Local banks and financial institutions with a local client base are also subject to exclusion, and there is a *de minimis* exception. However, the reality is that many institutions will be affected and must take steps to set up extensive due diligence systems to secure compliance. While Annex II is well-intentioned, there will be some Swedish institutions that incorrectly perceive themselves as being excluded from attracting subsidiaries of U.S. companies and U.S. citizens resident in Sweden as investors. The *de minimis* exclusions may have a relatively high ceiling by Swedish standards, but when applied internationally. Additionally, there will be a risk that institutions will over-report rather than under-report to be on the safe side, at least initially. As a result, "failure to prevent" is likely to become a major concern for institutions.

Finally, it is logical and beneficial for institutions to adopt and adhere to compliance systems that will automate the compliance process. The implementation of compliance systems should be acceptable to stakeholders. F.A.T.C.A. compliance, if not handled properly, must now be added as an increased risk factor.

CONCLUSION

F.A.T.C.A. is the new irritating reality in Sweden and many other jurisdictions. It creates substantial workloads for the institutions for what is essentially no local benefit. What may be worse, implementation of F.A.T.C.A. requirements causes great uncertainty in the financial services sector as it is viewed as yet another compliance risk. To quote an auditor contacted by the authors, "It is difficult to see any benefit to the client," but the I.G.A. means that F.A.T.C.A. is now the law of Sweden, which puts us all on the bumpy path to compliance.

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U.K. WINDFALL WINDING DOWN

After an arduous path through the courts regarding the creditability of the U.K. windfall tax, the Third Circuit followed the holding of the U.S. Supreme Court and found the tax to be creditable in a case involve PPL Corp.[103]

The U.S. and foreign countries can tax foreign-sourced income of U.S. taxpayers. To lessen the economic cost of double taxation, U.S. taxpayers are allowed to deduct or credit foreign taxes in computing income or net tax due. The amount of the U.S. income tax that can be offset by a credit cannot exceed the proportion attributable to net foreign source income. Code §901(b) specifies that a foreign credit is allowed only if the nature of the foreign tax is similar to the U.S. income tax and is imposed on net gain.

The U.S. entity PPL is a global energy company producing, selling, and delivering electricity through its subsidiaries. South Western Electricity PLC ("SWEB"), a U.K. private limited company, was an indirect subsidiary that was liable for windfall tax in the U.K. Windfall tax is a 23% tax on the gain from a company's public offering value when the company was previously owned by the U.K. government. When SWEB paid its windfall liability, PPL claimed a Code §901 foreign tax credit. This was denied by the I.R.S. and the long and winding litigation commenced.

Initially, the Tax Court found the windfall tax to be of the same character as the U.S. income tax. The decision was reversed by the Third Circuit Court of Appeals, which held that the tax was neither an income tax, nor a war profits tax, nor an excess profits tax. It took into consideration in determining the tax base an amount greater than gross receipts. Then, the Supreme Court reversed, finding that the predominant character of the windfall tax is an excess profits tax based on net income. Therefore, it was creditable. In August, the Third Circuit followed the Supreme Court's decision and ordered that the original decision in the Tax Court should be affirmed.

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[103] *PPL Corp. & Subs. v. Commr,* (CA 3 08/26/2014), reported unofficially at 114 AFTR 2d ¶2014-5190.

BIG WHOPPER OF A TAX SAVINGS

Burger King Worldwide Inc. ("Burger King") is moving its (tax) headquarters to Canada after an $11 billion buyout of the Canadian chain Tim Hortons Inc.

While there has been wide speculation regarding the motives for this transfer, Alex Behring, executive chair of Burger King and managing partner of its primary shareholder, 3G Capital, insists that the move was made for international growth rather than tax opportunities.

Under the current U.S. inversion rule, when a U.S. parent of a multinational company relocates its tax headquarters abroad, the ultimate U.S. tax liability on non-U.S. source income of affiliates is reduced as various provisions of the law – Code §61 never applies to the foreign shareholder and various provisions of Subpart F are inapplicable. Provided the move is approved, Burger King Worldwide Inc. will benefit from being taxed as a Canadian parent rather than American one. But such a move becomes problematic when 60% or more of the new parent company's shares continue to be held by the U.S. shareholders. Congressional bills such as the Stop Corporate Inversions Act of 2014 are directed at exactly this problem.

Besides the inversion impact, there are other legislative hurdles as well. Transactions involving substantial business activity in the foreign country similar to that in the U.S. are exempted from the inversion rule. However, Behring has his argument prepared. He claims that this transaction is mutually beneficial allowing the newly formed company to become an even larger fast food giant. This net benefit will need to be shown under the Investment Canada Act as well.

In addition to legislative hurdles, Burger King is facing pressure from senators to forego the move, claiming there will be a loss in customer loyalty and, ultimately, in sales. Objective evidence of this risk has not been made public by the senators. To date, there has been no incentive as significant as the projected $8.1 million in tax savings that would result from the move. The comments of the senators appear to be whopping big fabrications or "whoppers."

I.R.S. WARNS OF COSTLY PRANK CALLS

Over the summer, a number of taxpayers received unsolicited phone calls from persons claiming to be I.R.S. agents. These fake agents demanded money, often in an angry and threatening manner, and successfully duped taxpayers out of a reported total of $5 million. Over 90,000 complaints were received by the Treasury Inspector General for Tax Administration ("TIGTA"), who identified at least 1,100 victims in the fraud.

An audit released by the TIGTA shows that the I.R.S. engaged contract personnel who did not undergo the prescribed background investigations.[104] Couriers,

[104] Audit Report No. 2014-10-037, August 14, 2014.

printers, document recovery experts, and interpreters were given access to taxpayer data including names, addresses and social security numbers. In addition, the audit identified 20 contracts where personnel did not sign nondisclosure agreements.

While the I.R.S. works to rectify this breach, taxpayers are advised to remember that an initial communication from the I.R.S. will almost always take the form of official mail correspondence and not a cold call.

I.R.S. RELEASES NEW RULE ON I.T.I.N. TO EASE TAXPAYER BURDEN

The I.R.S. has recently taken steps to protect procedures involved in issuing the Individual Taxpayer Identification Number (the "I.T.I.N."), the nine-digit number issued to an individual who is required to have a U.S. taxpayer identification number but is not eligible to receive a social security number.

The I.R.S. began issuing the I.T.I.N. in 1996. Since that time, it has issued 21 million I.T.I.N.'s, but only a quarter of those issues are being used on U.S. tax returns.[105] In 2013, to protect the integrity of the program and safeguard the process, the I.R.S. established a rule under which new I.T.I.N.'s would automatically expire after five years.[106] This step was taken to ensure that I.T.I.N.'s were used for legitimate tax purposes.

On June 30th, the I.R.S. announced that it would stop automatically deactivating I.T.I.N.'s at the end of the five-year period. The new rule will apply to all I.T.I.N.'s, regardless of when they were issued. Under the new policy:

3. An I.T.I.N. will expire for any taxpayer who fails to file a federal income tax return for five consecutive years; and

4. Any I.T.I.N. will remain in effect as long as a taxpayer continues to file U.S. tax return (this includes I.T.I.N.'s issued after January 1, 2013).

To ease compliance procedures, the I.R.S. will not begin deactivating dormant I.T.I.N.'s until 2016.

According to Brenda Hales, a senior I.R.S. tax analyst, the new policy "will ensure that anyone who legitimately needs an I.T.I.N. for tax purposes can continue to do so, while at the same time resulting in the likely eventual expiration of millions of unused I.T.I.N.'s." If an I.T.I.N. has been deactivated, a taxpayer needing to file a U.S. return can reapply using Form W-7, *Application for IRS Individual Taxpayer Identification Number*. To file Form W-7 a taxpayer will need to submit original documents of identity by a foreign governmental authority or, if original documents cannot be submitted, copies of documents certified by the issuing governmental agency.

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105 IR-2014-76, June 30, 2014.

106 http://www.irs.gov/Individuals/Individual-Taxpayer-Identification-Number-(ITIN).

CHINA TAX AUTHORITIES FOCUS ON CROSS-BORDER SERVICE FEES, ROYALTIES

In what may be a significant transfer pricing initiative, China's central tax authority is coordinating a nationwide examination of cross-border I.P. and service fees, and local tax offices have been instructed to identify potential audit targets.

The period covered is from 2004 to 2013 and is expected to involve a number of transfer pricing audits with particular attention being given to payments made to companies in tax havens and other low-tax jurisdictions.

Service fees at issue would include fees for: (i) shareholder activities, (ii) management of the corporate group, (iii) services considered duplicative of those performed or supplied by third parties, (iv) services considered irrelevant to the Chinese entity based on its functions, risk profile, or business operations, and (v) services remunerated elsewhere.

Royalty payments at issue would include those made to entities incorporated in tax havens and those that serve no function or assume only a limited function, as well as large payments for intangibles that have depreciated in value.

The investigation will apparently apply to companies of all sizes including those who are not subject to transfer pricing documentation requirements under current Chinese law. This could be especially problematic for companies that are currently below the documentation thresholds, and advisors in China have recommended that such companies adopt procedures for capturing required documentation.

SINGAPORE PROPOSES NEW RULES REQUIRING EXPLANATION OF GLOBAL SUPPLY CHAINS

In a development somewhat similar to that in China, Singapore has proposed new transfer pricing documentation rules focused on contributions by related parties to an enterprise's global supply chains.

The proposed rules would require disclosure of the principal business activities and functions of each related party in the group, including charts showing the supply chains of products and services. The disclosures would include a functional analysis of each related party's value creation including the functions performed, risks assumed and assets. In addition, taxpayers would be required to disclose recent restructurings, acquisitions, and divestitures. If a holding company were a key member of the multinational group, taxpayers would have to provide an ownership chart showing the location and ownership linkages of the Singapore taxpayer with its ultimate holding company, intermediate holding companies, immediate holding company and all subsidiaries and associated companies directly and indirectly held by the Singapore taxpayer. An organogram showing the number of employees in each supply chain department would also be required.

These proposed rules have been issued under the auspices of Singapore's O.E.C.D.-based transfer pricing documentation regime put in place in February 2006.

IN THE NEWS

COMINGS AND GOINGS

Ruchelman P.L.L.C. is pleased to announce the addition of Sheryl Shah as a member of the Firm's New York office. Ms. Shah expands the global focus of the firm. She is a graduate of the University College of London (2008) and Pace University School of Law (2011). Prior to joining Ruchelman P.L.L.C., Ms. Shah was a member of an Israeli law firm where she consulted on international legal matters for foreign clients with U.S. interests.

OUR RECENT AND UPCOMING PRESENTATIONS

On June 5, 2014, Nina Krauthamer lectured on "International Estate Planning – The Basics." The workshop took place at New York Law School and addressed the fundamentals of estate tax planning for foreign persons, including withholding under the Foreign Investment in Real Property Tax Act ("F.I.R.P.T.A.").

On June 5, 2014, Stanley C. Ruchelman served as co-chair of the panel "Litigation Update" at the 7th Annual U.S. – Latin America Tax Planning Strategies conference in Miami, Florida. This panel discussed recent court decisions from Europe, Latin America, and the United States and the impact of those decisions on tax planning and compliance efforts.

On July 1, 2014, Nina Krauthamer participated in a Strafford Webinar, "Foreign Investment in U.S. Real Property: Tax Issues." She also presented a lecture on July 8, 2014, "Understanding Foreign Investment in U.S. Real Estate," as part of the two-day BNA Bloomberg seminar on *Current U.S. Tax Planning for Foreign-Controlled (Inbound) Companies.*

On July 25, 2014, Philip Hirschfeld spoke at New York University's *Advanced International Tax Institute*. The presentation, entitled "Foreign Persons Investing in U.S. Real Estate and Other Assets: Partnership and Other Structures, Treaty Planning and Financing Strategies," focused on tax-efficient structuring for non-U.S. persons investing in U.S. income producing and personal use real estate. It also addressed foreign investors looking to acquire U.S. mortgage debt and direct investment, as well as investment made in holding entities.

On August 10, 2014, Philip Hirschfeld participated in the panel "Planning for Foreign Persons Investing in U.S. Real Estate" at the 2014 ABA Annual Meeting in Boston. The panel focused on planning tips on how to structure an investment in U.S. real estate by a foreign investor in a tax efficient manner and foreign investors acquiring or originating U.S. mortgage debt.

On November 3-4, 2014, Galia Antebi will address “F.A.T.C.A. and the I.G.A. – How German business, U.S. Citizens, and German Financial Advisors are Affected” before the American German Business Club in Munich and Frankfurt, Germany. The presentation will include a top level review of Form W-8BEN-E for German businesses, Form W-9/W-8BEN for German resident individuals, and the due diligence process for the financial services sector.

Copies of our presentations are available on the firm website: www.ruchelaw.com/publications, or by clicking the above links.

About Us

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

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

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

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

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