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INSIGHTS

A GUIDE TO NON-DOM TAXATION

TAX 101: HOW TO STRUCTURE A CORPORATE DIVISION

ANTI-INVERSION RULES EXPANDED

CONGRESS ENACTS SWEEPING NEW PARTNERSHIP AUDIT RULES

AND MORE

Insights Vol. 2 No. 10

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EDITORS' NOTE

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

- **U.K. Non-Dom Taxation – Where it is and Where it is Going.** With the 15-year limit enacted to remittance based tax rules for non-domiciled individuals resident in the U.K., we offer a series of articles this month addressing favorable tax rules for non-domiciled resident individuals in several countries. Gary Ashford of Harbottle and Lewis L.L.P. in London is the lead-off author, explaining the U.K. tax and immigration rules and suggesting strategies for the long-term non-domiciled resident who faces the 15-year ceiling. The ceiling becomes effective in 2017.

- **Non-Dom Taxation: Ireland as an Alternative to the U.K.** The benefits and possible pitfall of Ireland's non-domiciled taxation rules are explained by Lisa Cantillon and Jane Florides of Kennelly Tax Advisers in Dublin. Remittance based taxation remains strong in Ireland, but planning is required to steer clear of deemed remittance traps and to minimize inheritance tax exposure.

- **The *Forfait* Tax Regime in Switzerland – A Venerable Alternative.** The Swiss *forfait* tax regime is discussed by Michael Fischer of Froriep in Zurich. The *forfait* is battletested and has beaten back a referendum in 2014 that would have repealed the benefit. Beware – the forfait is not available in all cantons and the minimum tax rate varies widely. In comparison to the U.K. and Ireland, remittances from abroad are not penalized with tax.

- **Spanish Tax Regime for Incoming Professionals.** Heard of the "Beckham Law" that limits income tax in Spain for certain non-domiciled individuals? Think of European football (soccer) players. Pablo Alarcón Espinosa of Alarcón-Espinosa, Abogados in Madrid explains how persons migrating to Spain for work purposes can avail themselves of a reduced tax regime for domestic income and an exemption for foreign income and gains. Like Switzerland, remittances from abroad are not penalized with tax.

- **What is the Future for New Immigrant Benefits?** Guy Katz and Danielle Halimi of Herzog Fox and Neeman in Tel Aviv explain the Israeli tax benefits for those individuals who are categorized as "New Immigrants." Benefits begin with a ten-year exemption for foreign-source income and gains – the exemption applies to both tax and information reporting. Regular returning residents receive generous but scaled back benefits. Remittances from abroad are not penalized with tax.

- **Portugal: A Race Towards Tax Competitiveness – The Non-Habitual Tax Resident Regime.** Alexandra Courela and Susana A. Duarte of Abreu Advogados in Lisbon explain the Portuguese approach in extending tax benefits to new arrivals holding "Golden Visas" or who otherwise qualify for work-related visas for the performance of designated high value activities. Employment income from services performed in Portugal is taxed at a low rate and foreign source service income may be exempt from tax if certain conditions apply. Foreign-source plain vanilla investment income and gains may be exempt, too.

- **Congress Enacts Sweeping New Partnership Audit Rules.** Philip Hirschfeld and Nina Krauthamer explain new partnership audit rules enacted by Congress in November as part of the Bipartisan Budget Act of 2015. With limited exception, partnerships will become liable for tax increases arising from audit adjustments. This treatment raises the importance of tax indemnities when partnership interests are acquired.

- **Tax 101: How to Structure a Corporate Division.** With all the brouhaha over the announced Alibaba spinoff by Yahoo!, Elizabeth Zanet explains the circumstances in which a corporate division – known as a demerger in many countries – can be achieved in a tax-free manner under U.S. tax law. The path is not easy as these divisions are the lone vestiges allowing tax-free corporate distributions of appreciated assets under U.S. tax law.

- **Mylan's Opposition to the I.R.S. – No Substantial Rights.** Last month, Christine Long analyzed the basis of the I.R.S. motion for summary judgment in *Mylan Inc. v. Commr.*, a case addressing whether a license that relinquishes all substantial rights in a patent is the equivalent of a sale, so that basis can be recovered and capital losses can reduce the resulting capital gain. This month, she analyzes the taxpayer's opposition to the motion. In addition to the existence of material questions of fact that were ignored by the I.R.S., the taxpayer argues economic substance in support of its position and evaluates the rights that were transferred and those that were retained.

- **Anti-Inversion Rules Expanded.** Kenneth Lobo looks at recent I.R.S. countermeasures attacking cross border mergers that the I.R.S. views as inversions. Among other measures, rules are announced to limit planning alternatives using check-the-box entities to stuff assets into an acquirer without exposing those assets to tax in the jurisdiction of residence of the acquirer and use of parent-company stock as the consideration for the acquisition.

- **Corporate Matters: Directors and Officers Insurance.** This month, Simon Prisk looks at directors and officers insurance policies designed to protect incumbents from liability claims based on a failure to supervise the actions of a company. He cautions management to be wary of coverage gaps when comparing policies and costs.

- **F.A.T.C.A. 24/7.** Philip Hirschfeld and Galia Antebi discuss recent developments in F.A.T.C.A. practice, including upgrades to the online registration system, a flurry of competent authority arrangements signed with other countries, F.A.T.C.A. guidance issued by the Turks and Caicos Islands, new authorizing statutes in Russia and Georgia, an implementing memorandum in Germany, an I.G.A. with Angola, updated F.A.Q.'s, and a list of Model 1 and Model 2 I.G.A. partner countries.

- **Updates & Tidbits.** Sheryl Shah looks at two recent developments in the E.U. The first relates to findings of illegal state aid in the form of private rulings given by Luxembourg and the Netherlands – Starbucks and Fiat plan to appeal. The second relates to double dipping of tax benefits when establishing I.P. box companies.

- **Global Village on the Move India 2015.** Sheryl Shah spent ten days at a program that was held at VIVA College in India for young professionals. Known as the Global Village on the Move, it is an annual leadership development program organized by the Iacocca Institute at Lehigh University. The experience was unique for a lawyer just beginning a career.

We hope you enjoy this issue.

- The Editors

U.K. NON-DOM TAXATION – WHERE IT IS AND WHERE IT IS GOING

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Tags
Non-Dom
Pre-Immigration Planning
Remittance Basis
Tax Residency
U.K.

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INTRODUCTION

The granddaddy of all national legislation adopting a favorable tax regime designed to entice wealthy foreign nationals to establish residence is the set of special rules in the U.K. that have applied to non-domiciled individuals ("Non-Doms"). The headline benefit is remittance taxation regarding foreign-source income and gains, meaning that tax is deferred until the proceeds of the foreign-source income and gains are remitted to the U.K. Recent legislation in the U.K. has announced that remittance basis taxation – the bulwark of the Non-Dom rules – will terminate in April 2017 for persons who have been tax resident in the U.K. for 15 out of 20 years. There will also be a major change in the taxation of Non-Doms that are beneficiaries of nonresident trusts. This article looks at the special rules that continue to be offered to Non-Doms other than long-term Non-Doms and comments on several tax plans that might be recommended for the long-term Non-Dom at the time when they face a new tax reality.

NON-DOMS MOVING TO THE U.K.

For a non-domiciled nonresident individual wishing to relocate to the U.K., pre-immigration tax planning often is viewed as necessary to avoid significant unintended tax liabilities.

Who and What is a Non-Dom?

Under U.K. tax law, a person's domicile (separate from residence), provides an opportunity to be taxed as a resident in a way that is different and more beneficial than the way other residents are taxed. A person who is resident and domiciled in the U.K. is effectively taxed on a worldwide basis with credit given for foreign tax paid. In comparison, an individual who is resident but is a Non-Dom can elect to be taxed on a remittance basis. Those electing for the remittance basis of taxation are taxed on all U.K.-source income and gains, but in terms of foreign income and gains, are taxed only to the extent of the foreign income and gains are actually remitted to the U.K.

Domicile follows the principles set down in private international law. The main areas of domicile borrowed by the U.K. tax law are the domicile of origin, domicile of choice, and domicile of dependency. Any person born outside the U.K. to parents who are themselves born outside the U.K. will almost certainly fall within the Non-Dom category. Such persons have a domicile by origin and the origin is at the place of birth. These people are the focus of this article.

U.K. Tax Residence

The remittance basis of taxation for Non-Doms comes to life only when the person becomes a U.K. tax resident. As of April 6, 2013, the U.K. introduced a Statutory Residence Test ("S.R.T."). The S.R.T. sets out the various tests for determining a person's residence. There are tests for automatic U.K. residence and non-U.K. residence. There are "sufficient ties" tests for determining residence for those cases which fall outside the automatic tests.

Automatic U.K. Residence Tests

There are three main tests for automatic U.K. residence:

- Presence in the U.K. for 183 days or more
- Having a home in the U.K. for a period of 90 days within the relevant tax year and using the property for a continuous period of 30 days during that period
- Full-time employment in the U.K.

Where an individual does not meet the automatic U.K. residence tests, residence might still exist by virtue of the number of days of presence in the U.K. and the number of ties maintained with the U.K. For those who have not been resident in the U.K. previously, there are four possible ties:

- Accommodation
- Family
- Work
- Ninety days of presence

Depending on the number of days and the number of ties, the individual might be viewed as resident. If the person has all four ties, he or she could be regarded as resident where the person has been present in the U.K. for as little as 46 days. Where the person is present in the U.K. for more than 120 days in a tax year and only two ties exist, residence in the U.K. may also exist.

Split Tax Year Rules

If an individual arrives in the U.K. in the middle of the tax year, rules exist allowing an individual to be nonresident for the period prior to arrival. This is known as the "split tax year rules." This treatment is not automatic, so it is important to consider these rules prior to arrival in the U.K. Otherwise, the individual could be liable to tax on worldwide income in the entire first year of residence, subject to the Non-Dom rules set out below.

The main factual circumstances where the split tax year rules can be applied in relation to those coming to the U.K. are

- starting to have a home (only) in the U.K.,
- starting full-time work in the U.K.,

- ceasing full-time work overseas,
- being a spouse or partner of someone ceasing full-time work overseas, and
- starting to have a home in the U.K. even if it is not the only home.

If someone comes to the U.K. and becomes resident, the benefit of the split tax year rules will not be available unless one of the above facts exists.

TAX RULES FOR NON-U.K. DOMICILARIES

Where the individual has become a U.K. tax resident, but is a Non-Dom, an election may be made to be taxed on the remittance basis. As mentioned above, the remittance basis of taxation taxes the foreign income and gains of the Non-Dom only when remitted to the U.K. The rules around what is or is not a remittance are voluminous and complex. In essence, a remittance will occur if a "relevant person" receives, uses, or brings to the U.K. foreign income and gains relating to the period after becoming a resident. Therefore, income and gains made prior to becoming a resident can be brought into the U.K., as the proceeds from those transactions will be regarded as "clean capital," which is discussed below.

There are several technical rules that apply to persons wishing to be taxed under the remittance basis. Briefly, these may be summarized as follows:

- Where an individual's foreign income and gains are less than £2,000 the remittance basis rules apply automatically.
- Where a person has been resident in the U.K. for seven out of nine tax years, as of April 6, 2008 a remittance basis charge ("R.B.C.") is required in order to retain the benefits of remittance basis tax rules. Currently, the R.B.C. amounts to £30,000 beginning in the eighth year of residence. The R.B.C. increases to £60,000 after 12 years of residence and £90,000 when the person has been resident for 17 years. In order for the R.B.C. to be a creditable tax for U.S. persons, the R.B.C. deems the Non-Dom as "nominating" some of the foreign income and/or gains to be taxed in the U.K. This nomination effectively creates an income tax charge equivalent to the R.B.C.
- The individual newly arriving in the U.K., who has not been resident previously, need not therefore have to worry about this for seven years.

There are some differences between the R.B.C. rules that claw back income tax benefits for a Non-Dom and the benefit claw-back rules for U.K. inheritance tax purposes. For purposes of the inheritance tax, there is a deeming provision under which a person who has been a U.K. resident for 17 out of 20 tax years will be deemed to be U.K. resident.

2015 BUDGET CHANGES

The U.K. government announced proposals for significant changes to the tax rules for Non-Doms. H.M.R.C. has stated that the new changes will be effective from April 6, 2017, and H.M.R.C. has not as yet published the final draft legislation or technical guidance. These are anticipated in January 2016. The changes may be summarized as follows:

- The first is a change in domicile rule for a person who was born with a U.K. domicile and acquired a domicile somewhere else after having left the U.K. for a minimum period of three years. Should that person return to the U.K., U.K. domicile will exist automatically upon return.
- The second is a deemed domicile provision for all U.K. tax purposes. Where an individual has been resident in the U.K. for 15 years as of April 6, 2017, the person will be deemed to be U.K. domiciled for all U.K. tax purposes beginning with the 15th year. This new rule, will effectively override the current 17-out-of-20-years deeming rules for inheritance tax purposes and the current rule for the increased R.B.C. at that point in time.

Long-term Non-Doms have already begun to consider revising tax affairs in response to these changes. There is no doubt that some Non-Doms are considering becoming nonresident before April 6, 2017 or, if they have not yet been resident for 15 years at that point, becoming nonresident prior to triggering a deemed domicile in the U.K.

For others who do not wish to leave the U.K., H.M.R.C. has provided some guidance to the thinking of Ministers and some planning can begin at this time. For example, H.M.R.C. has advised that it plans to align the rules for becoming nonresident in the U.K. and acquiring a new domicile elsewhere for inheritance tax purposes. Currently, there is a three-year rule for inheritance tax for U.K.-domiciled individuals but a four-year rule for deemed Non-Doms. H.M.R.C. is proposing an aligned period of five years. H.M.R.C. has said it will consult on the interaction between the new five-year rule and the old three- and four-year rules.

"The proposed rules around returning U.K. Non-Doms will restrict this opportunity to those who did not have a U.K. domicile at birth. Those with a U.K. domicile at birth may need to consider leaving the U.K. for good and resettling elsewhere."

H.M.R.C. has indicated that under the new rules, after April 6, 2017, if an individual leaves the U.K. and a new domicile is acquired somewhere else (including perhaps the individual's domicile of origin outside the U.K.), the 15-year "clock" under the deemed domicile rule could be restarted. The proposed rules around returning U.K. Non-Doms will restrict this opportunity to those who did not have a U.K. domicile at birth. Those with a U.K. domicile at birth may need to consider leaving the U.K. for good and resettling elsewhere.

We also understand that a person who would be deemed U.K. domiciled under the new 15-year rule on April 6, 2017 who leaves the U.K. before April 6, 2017, will be treated under the current rules, rather than the post-April 6, 2017 version of the rules.

Other tax planning is less extreme. The U.K. government has set out that the current Non-Dom rules will remain as they are until April 6, 2017, and they will potentially accept planning that is undertaken under the current rules prior to that date. Particularly, in relation to inheritance tax, where an individual is not yet deemed to be U.K. domiciled under the current 17-out-of-20-years rules, this would appear to support the opportunity to settle non-U.K. property by gift to the next generation or by transfer to an offshore trust. Provided the individual lives long enough, the property could fall out of inheritance tax exposure in the future under the excluded property rules.

H.M.R.C. has said it will also consider changing some of the anti-avoidance rules, such as the Transfer of Assets Abroad rules, to protect some of the structures set up before April 6, 2017.

The new proposals also raise questions over Non-Dom banking facilities. Will it be effective, for example, to have separate bank accounts for offshore income and gains generated before the new law and different bank accounts for income and gains after the changes? Our understanding is that some consideration is being given to this in the government, but clearly, if nothing further is introduced or issued on this matter, that would appear to be a sensible possible solution.

In summary, while there is definitely scope to begin conversations with affected clients, or those Non-Doms who will be affected in the future, some caution would be advised until the draft legislation and technical guidance is published.

RIGHT TO RESIDE AND WORK IN THE U.K.

The U.K. immigration system is split between (i) citizens of the European Economic Area (the "E.E.A."), which is wider than the E.U., and Switzerland; and (ii) migrants from outside these countries. Most citizens of countries within the E.E.A. and Switzerland have the right to live and work in the U.K. without restrictions. They may also bring their families with them to live in the U.K., provided they are able to support themselves without recourse to public funds.

The U.K. has a tiered points-based system, which applies to migrants from outside the E.E.A. and Switzerland and is appropriate for individuals working or setting up businesses in the U.K. This portion of the article will focus on Tier 1, which is aimed at high-net-worth and highly skilled individuals who will contribute to the U.K.'s productivity and growth, and specifically on the Tier 1 (Investor) and Tier 1 (Entrepreneur) routes. Family members can also seek leave to enter the U.K. as the dependents of a points-based-system migrant.

Tier 1 (Investor)

The Tier 1 (Investor) route requires individuals to have at least £2 million available to invest in the U.K. The funds must belong to the applicant and have been held for at least three months prior to making the application. If the funds have not been continuously held for that period, the individual can still satisfy the requirement provided it can be demonstrated that the funds have come from acceptable sources including a gift, deed of sale, inheritance, or winnings.

Investment of such funds must be made in U.K. government bonds, or share or loan capital in active and trading U.K. companies, and must be maintained throughout the duration of the visa. Funds invested in property do not count toward investment under this route. An initial visa will be granted for three years and can be extended for a further two years. Assuming the initial investment has been maintained and the individual has remained in the U.K. for a period of five years, the migrant may qualify for settlement in the U.K. (known as Indefinite Leave to Remain ("I.L.R."). In order to qualify for I.L.R., absences from the U.K. must not exceed 180 days in any 12-month period.

The route to settlement can be accelerated if applicants are willing to invest £5 million or £10 million; under these categories, assuming the investment is maintained, the individual may be eligible for I.L.R. after two or three years respectively.

The Tier 1 (Investor) is an attractive route as it allows unrestricted employment or self-employment in the U.K. and an accelerated route to settlement in the U.K.

Tier 1 (Entrepreneur)

The Tier 1 (Entrepreneur) route is for individuals who wish to set up, join, or takeover a business in the U.K. An applicant must have access to £200,000 available for investment into a new or existing business in the U.K. The funds must be held in a U.K. regulated financial institution or be transferable to the U.K. Evidence must be submitted to show that the individual intends to set up or join the business, invest the relevant funds, and not seek employment other than in the identified business. As part of an application, the individual must demonstrate the status as a "genuine entrepreneur" by providing information about the business they intend to invest in, a business plan, and personal background.

"The Tier 1 (Investor) is an attractive route as it allows unrestricted employment or self-employment in the U.K. and an accelerated route to settlement in the U.K."

If the visa is granted, the applicant must register as a director of the company, invest the sum of £200,000 in cash into the business, and ensure that the business creates two new full-time jobs for settled persons in the U.K. for at least 12 months. The funds must remain available to the Tier 1 (Entrepreneur) at all times until they are spent in the running of the business.

The sum of £200,000 may be reduced to £50,000 in circumstances where the funds are being provided by certain U.K. venture capitalists, seed funding competitions, or government departments.

After five years in the U.K. as a Tier 1 (Entrepreneur), the individual may be eligible to qualify for I.L.R. provided that absences from the U.K. do not exceed 180 days in any 12-month period.

Visitor Visas

Non-E.E.A. nationals may enter the U.K. outside of the points-based system as a visitor for up to six months in a 12-month period. However, the visitor rules are limited and individuals are not able to carry out productive work in the U.K., whether paid or unpaid. A business visitor is able to attend meetings, conferences, and seminars; negotiate and sign deals and contracts; and gather information for an overseas employer; but must not receive payment from a U.K. source and must not intend to transfer a permanent work base to the U.K. Even temporary transfers of a base are prohibited.

PRE-ARRIVAL TAX PLANNING

It is very important to plan the individual's affairs before arrival in the U.K. This is equally important for the whole family, individually, in terms of children in their own right and the residence of parents. As mentioned above, the residence of a parent is affected by family ties in the U.K. Consequently, within a family, each person's tax residence position will affect the positions of other family members.

“While planning for an event that is 15 years in the future is often difficult for practical reasons, it is still important to look at whether any structuring should be undertaken to address exposure to asset protection and future inheritance tax.”

As stated above, the Non-Dom rules allow a Non-Dom to choose the method for recognizing income and gains from sources outside the U.K. between (i) the worldwide arising basis of taxation and (ii) the remittance basis of taxation. Therefore, it is imperative for a Non-Dom to review non-U.K. banking facilities prior to arrival.

It is very important to set up separate accounts for the Non-Dom. All overseas monies of the Non-Dom amount to what is “clean capital” up until the day of arrival in the U.K. This assumes that the individual had no previous periods of U.K. residence. Providing that clean capital remains segregated from any post-residence income and gains, the clean capital can be brought into or used by the Non-Dom in the U.K. during a period of residence without the imposition of tax. If any income and gains are not segregated as they arise after an individual becomes a U.K. resident, the clean capital fund will become a “mixed fund.” The result of this is that any monies remitted to the U.K. from a mixed fund will effectively be treated as a remittance of income, and taxed at the relevant rate of income tax. The current highest rate of income tax is 45%. Income or gains should be segregated into new accounts as they arise, leaving the original “capital” for future use by the U.K.-resident Non-Dom.

It is worth setting up an account for income such as interest and one for capital gains. This allows the Non-Dom to control the order of remittances. The first remittances would come exclusive from clean capital until the fund is exhausted. The next tranche of remittances would be made exclusively from the capital gains fund until that fund is exhausted. This limits the U.K. tax on the remittance to the favorable capital gains rates, currently 28%.

Once a Non-Dom begins paying the R.B.C. after the seventh year of residence, it is important to nominate an amount of foreign income and/or gains to be taxed to create the R.B.C. Note that if that nominated income is remitted to the U.K., the U.K. tax rules will look beyond the nominated amounts to identify an equivalent amount of unremitted income and/or gains that will be taxed in addition to the R.B.C.

While planning for an event that is 15 years in the future is often difficult for practical reasons, it is still important to look at whether any structuring should be undertaken to address exposure to asset protection and future inheritance tax. At the time of writing this article, technical guidance has not yet been issued on how the 2015 Budget will be implemented as of April 6, 2017. This guidance is eagerly awaited in order to allow tax advisers in the U.K. to be fully able to consider any specific planning that should be undertaken. However, issues such as whether pre-2017 income and gains should be separated from post-2017 income and gains, will have to be considered, as well as the whole issue of offshore assets that would currently be regarded as “excluded property” for inheritance tax purposes for non-U.K. situs assets held by a Non-Dom who is not yet deemed domiciled under the 17-out-of-20-years rule.

OTHER FOREIGN-SOURCE INCOME

As the U.K. Non-Dom remittance rules seek to tax U.K.-source income and remitted foreign-source income, various planning opportunities exist. For example, where a Non-Dom is an extensive world traveler, there may be scope to structure affairs so that income earned overseas is not remitted to the U.K. This income would be placed into a foreign account and no U.K. tax would be due. Care must be taken to coordinate with taxing regulations outside the U.K. as, typically, income tax treaty benefits are not allowed for unremitted income of a Non-Dom who computes tax on the remittance basis of taxation. If the person is considering leaving the U.K. at some point in the future, this approach may convert deferral into forgiveness if the facts are appropriate.

It is very important to look at family office structures to make sure they are compliant with U.K. tax rules. If a family office structure is set up, the U.K. Non-Dom rules can provide good opportunities for those internationally focused families operating in different jurisdictions.

BUSINESS INVESTMENT RELIEF

Entrepreneurial Non-Doms may be interested in this relief. The relief effectively overrides the normal remittance rules of taxing foreign income and gains earned after the individual becomes resident, providing they remit the funds into what is, or is intended to be, a "qualifying investment." A qualifying investment involves taking shares in or making a loan to an eligible trading company, which is primarily engaged in carrying on a trade in the U.K., or will do so within two years of the investment being made.

It is very important that the investment funds are placed into the company within 45 days of remittance in order to avoid application of the ordinary remittance basis taxation rules. It is also important that, when the funds are taken back from the company, they flow overseas or are reinvested into another eligible trading company within 45 days.

CONCLUSION

Although the headline news is the tightening of the remittance basis of taxation rules, the U.K. remains an attractive place for a wealthy Non-Dom. The 15-year period of benefits is significantly longer than in most countries having favorable Non-Dom tax regimes, significant planning can be considered around this relief. As with most cross-border movers, pre-immigration planning is often crucial, separating actual benefits from what-if regrets.

NON-DOM TAXATION: IRELAND AS AN ALTERNATIVE TO THE U.K.

Authors
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Tags
Ireland
Non-Dom Taxation
Remitance Basis
Tax Residency

INTRODUCTION

Ireland has long been overlooked as a destination for non-domiciled ("Non-Dom") individuals. With changes to the U.K. Non-Dom regime scheduled to take effect in 2017 for long-term Non-Doms, mobile taxpayers are looking for alternatives and Ireland should be considered.

This article will look at the Irish legislation and how its Non-Dom regime operates. The statutory residence test is simple to apply and planning opportunities are possible for Non-Dom individuals living in Ireland.

An individual's domicile is relevant for determining the extent of exposure to Irish taxation. In this context, individuals living in Ireland can be broadly classified into two categories: Irish domiciled or non-Irish domiciled.

An individual who is resident in Ireland but who is not Irish domiciled is liable to Irish tax on all income and gains arising in Ireland. However, there is no Irish tax on foreign income and gains provided that the proceeds of the income or gain are not remitted into Ireland. This is known as the *remittance basis of taxation*.

We will start by explaining how an individual becomes tax resident in Ireland. Legislative references are bracketed and each reference is to the Taxes Consolidation Act 1997.

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Lisa Cantillon is an Associate Director, also with Kennelly Tax Advisors, and with particular expertise in the expatriate area

The firm has been providing private client tax advice for almost 20 years and has a team of 14 personnel advising private clients on all aspects of their tax affairs. The firm's clients include many wealthy non-domiciled individuals living in Ireland.

TAX RESIDENCE IN IRELAND [§819 TCA 1997]

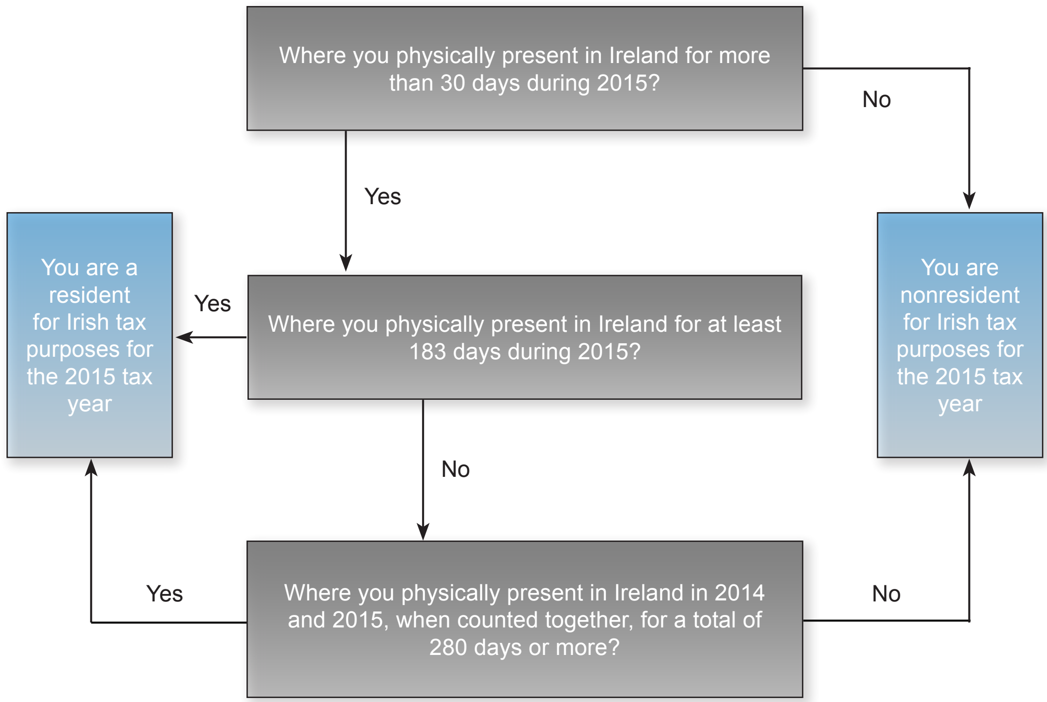
Tax residence in Ireland is determined by reference to the amount of days that an individual spends in Ireland in each tax year. The tax year runs from January 1 to December 31. An individual is resident in Ireland under Irish domestic tax rules if either of the following tests is satisfied:

- The individual is physically present in Ireland for 183 days or more in a calendar year
- The individual is physically present in Ireland in the calendar year concerned and the previous calendar year for a total of 280 days or more, with the proviso that if the individual is in Ireland for not more than 30 days in a calendar year, Irish tax residence cannot be established under the 280-day test for that year

An individual who does not meet either the 183-day test or the 280-day test is regarded as non-resident for Irish tax purposes. Therefore, on a continuous basis, an individual who spends fewer than 140 days in Ireland in each tax year will be nonresident. Conversely, an individual only needs to spend 140 days or more in Ireland on a continuous basis in each tax year in order to remain Irish tax resident.

An individual is deemed to be present in Ireland for a day if present in Ireland at any time during that day (regardless of the purpose of the stay).

Decision Tree for Determining Residence Status[1]



DOMICILE

The domicile of an individual is relevant for determining the level of Irish tax due.

The Irish definition of "domicile" is the same as that used in the U.K. In short, domicile is the country which is considered to be a person's permanent home and is distinct from legal nationality and from residence. At birth, a person acquires a domicile of origin, normally the domicile of the father. No person can be without a domicile and it is not possible to have more than one domicile at the same time.

A domicile of choice can be acquired by making a permanent home away from the individual's domicile of origin and by severing all ties with the original country so that it is clear that the individual has abandoned the idea of ever returning to live in their country of birth. There has to be clear evidence that the individual has a positive intention to permanently reside in another country.

For a foreign national moving to Ireland who wishes to maximize their Irish tax situation, the key is to retain foreign domicile status. This allows the individual to access the benefits of remittance basis of taxation.

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[1] This example is based on the 2015 tax year.

Evidencing a Foreign Domicile – Practical Points to Note

A detailed discussion on the meaning of domicile is outside the scope of this article, but some practical points are set out below.

In order to become Irish domiciled, a Non-Dom individual would need to take up permanent residence in Ireland with the intention of remaining there indefinitely and not returning to the country where previously domiciled before moving to Ireland.

It would be extremely difficult for any revenue authority to argue in the first few years of residence that a Non-Dom individual has become Irish domiciled. This is because any person moving to a new country will naturally take a number of years to ascertain whether or not this is the place where the individual wishes to live for the rest of his or her lifetime.

"Once a Non-Dom individual has been living in Ireland for a number of years (say 20 or 30 years) it will be necessary to take some steps to demonstrate the retention of foreign domicile and the absence of an Irish domicile of choice."

However, once a Non-Dom individual has been living in Ireland for a number of years (say 20 or 30 years) it will be necessary to take some steps to demonstrate the retention of foreign domicile and the absence of an Irish domicile of choice. Some of the suggested actions a Non-Dom individual should consider taking include one or more of the following:

- Maintaining a burial plot in the country of foreign domicile
- Having a last will and testament prepared in the country of foreign domicile
- Maintaining ties with the country of foreign domicile, such as frequent visits to family and friends or membership in business organizations or clubs in the country of foreign domicile
- Having economic ties with the country of foreign domicile, such as investment interests, business dealings, and similar items

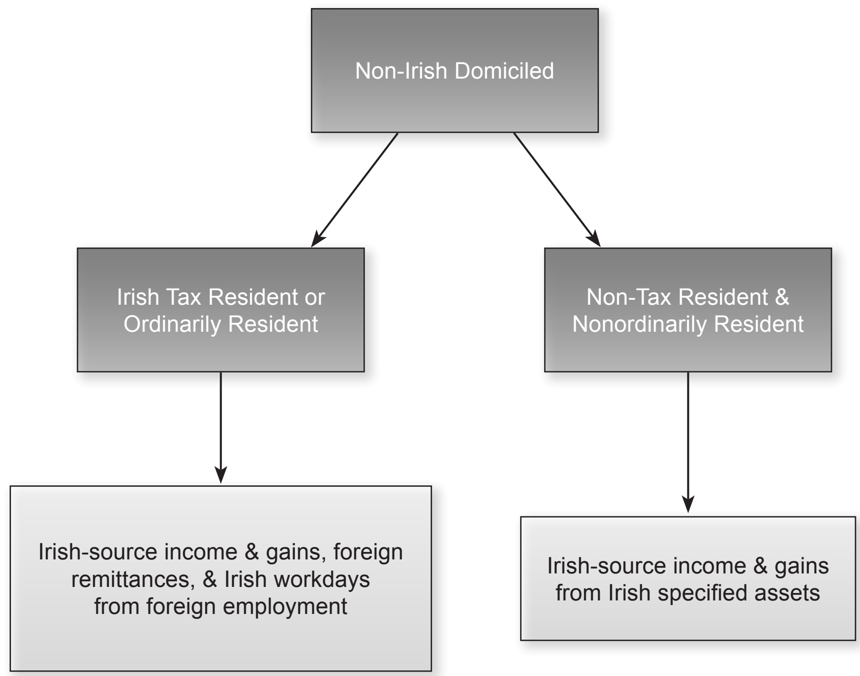
Based on a 2011 U.K. case, *Perdoni v. Curati* (2011 EWHC 344), the above conditions may not in themselves be sufficient to demonstrate domicile. There must be an intention to return to the country of foreign domicile on the happening of a "clearly foreseen and reasonably anticipated contingency." In other words, this means that although a Non-Dom individual may be living in Ireland at the moment, the individual must be able to identify a point in time when a return to the country of origin is anticipated. Examples include

- the event of a spouse's death (particularly where the individual is significantly younger or in better health than the spouse),
- retirement,
- graduation of children/grandchildren from the Irish school system, or
- a change of regime in the individual's home country.

It is good practice for Non-Dom individuals to review the domicile position with a tax adviser every few years and have the adviser note the review findings on the individual's file. As the question of domicile is based on subjective intent of the individual at any point in time, this exercise will result in a third party's documented report that identifies and evaluates the individual's specific intentions. This would be useful in the event that Revenue were to ever challenge domicile.

The mechanics of claiming a foreign domicile are simply to tick the “non-domiciled” box on the tax return and to file the return on that basis. There is no automatic process of agreeing upon an individual’s domicile position with the Revenue, unless an individual wishes to do this for personal reasons or in the unlikely event of a Revenue audit.

The Charge to Irish Tax for a Non-Dom Individual



An individual becomes ordinarily resident after being resident in Ireland for three consecutive tax years, and does not lose this status until a period of non-residence exists for at least three consecutive tax years.

As can be seen from the above diagrams, an individual who is resident in Ireland but not Irish domiciled is liable to Irish income tax on all income arising in Ireland. However, Irish income tax on foreign income is limited to the extent that such income is remitted into Ireland. Again, this is known as the *remittance basis of taxation*.

REMITTANCE BASIS OF TAXATION [§71 TCA 1997]

An individual who is Irish resident but Non-Dom is taxed in Ireland on Irish-source income or gains and on the proceeds of any income remitted to Ireland. The remittance basis of taxation in Ireland means individuals are taxable on foreign income only when that income is brought into Ireland. All Irish income or gains remain subject to full Irish taxation.

Application of Rules to Proceeds of Income and Gain

Once an individual qualifies for the remittance basis, tax is assessed on foreign-source income on the full amount of **actual sums received** in Ireland from the following items:

“If a Non-Dom individual has funds built up out of non-employment income prior to the tax year of arrival in Ireland, these are treated as capital.”

- **Money brought into Ireland** – for example, foreign employment income that is deposited in an Irish bank account
- **Property imported into Ireland** – for example, a painting that is purchased from foreign earnings and brought into Ireland
  - There is a technical difference between the treatment of income and capital gains. For the proceeds of income to be remitted, the painting would have to be sold in Ireland. In comparison, for the proceeds of capital gains to be remitted, it would be sufficient to bring the painting to Ireland.
- **Money or value arising from property not imported** – for example, a painting that is purchased with the proceeds of foreign income and then disposed of abroad with a following remittance of the proceeds to Ireland
- **Money/value received on credit** – for example, a foreign credit card that is used in Ireland
  - The use of a foreign credit card to obtain cash from an A.T.M. is a remittance. Furthermore, the use of a foreign credit card to purchase goods in Ireland also gives rise to a remittance.

Taxation Triggers

In determining whether sums received in Ireland are taxable remittances of income or gain, three factors must be present:

1. There must be income or gain.
2. The income or gains must arise from a foreign security or possession.
3. The proceeds of the income or gain must have been sent from that foreign source to Ireland.

Effect of a Change of Domicile

Over time it is possible that a Non-Dom individual may acquire an Irish domicile while accumulating foreign income abroad. Subsequent remittances of this accumulated foreign income are not taxable once an Irish domicile has been acquired. This contrasts with the position for foreign gains, which still cannot be remitted without a tax charge after a change of domicile. However, deciding if and when an individual has acquired a domicile of choice can be a difficult matter. The facts of each particular case need to be reviewed on their own merit.

Practical Points

The legislation and case law governing the remittance basis is complex and extensive. Remittances must be planned carefully. If not, a remittance may result in an additional tax liability.

The following points should be noted:

- Only remittances out of income are liable to income tax. Remittances out of capital are not liable to income tax. If a Non-Dom individual has funds built up out of non-employment income prior to the tax year of arrival in Ireland, these are treated as capital.

- Any income earned from a foreign employment up to the date of arrival in Ireland is not taxable if remitted to Ireland. Relief known as split-year residence may be applicable.

- Where there are remittances from a "mixed fund" (*i.e.*, capital and income), the income is considered to be remitted first in the Revenue's view. When all income has been fully remitted, the Revenue will accept that subsequent remittances are capital. To ensure that money remitted to Ireland is not considered income, separate bank accounts should be maintained for income and for capital.

- With a view to avoiding this problem of having mixed funds, an individual who has capital accumulated at the time of arrival in Ireland should keep that capital separate from any foreign sources of income earned while the individual is resident in Ireland. For bank accounts or cash, this can usually be achieved in a relatively straightforward way by keeping two separate accounts in a foreign bank. This makes it possible for an individual to choose the account from which funds are remitted.

- Foreign-source income does not lose its character as income simply because it is invested in a capital asset. For example, a liability to income tax might arise where a valuable car/racehorse/yacht is purchased abroad using foreign income and imported into Ireland. When the asset is sold in Ireland, the proceeds of sale are treated as a remittance of income. The same adverse result is achieved when the asset is sold outside of Ireland and the proceeds of the sale are remitted to Ireland. This is a deemed remittance of income.

- It is not only remittances of money that are subject to tax. The importation of property and loans borrowed abroad can also be regarded as remittances of gains, as discussed below.

- Use of a foreign credit card or debit card to pay for items in Ireland may constitute a remittance.

- Where an individual has an Irish tax liability that is settled out of the proceeds of untaxed foreign earnings maintained abroad, the settlement is considered to be a taxable remittance.

- A Non-Dom individual that has paid foreign tax on a source of income should consider remitting the proceeds of the taxed income first. This allows the individual to claim a foreign tax credit in Ireland. This suggests that highly taxed foreign income should be maintained in a separate foreign bank account from low taxed or no taxed income.

- Where Non-Dom individuals report income on the remittance basis of taxation and repay loans of any sort, the loan repayment will be considered a remittance and §72 TCA 1997 must be considered in detail, as discussed below.

- Income from offshore fund investments benefit from the remittance basis of taxation. On the other hand, gains derived from investments in offshore funds do not benefit from the remittance basis of taxation. They are taxed even if the money is not brought into Ireland. Applicable tax law specifically states that gains derived from offshore funds are taxed under Schedule D

Case IV, and the remittance basis is available only for items taxable under Schedule D Case III, which covers almost all other sources of foreign income. Many European investment funds are treated as "offshore funds" for Irish tax purposes. Therefore, it is important for a foreign-domiciled individual to have an Irish tax adviser review his or her investment portfolio to ensure it only contains investments that benefit from the remittance basis of taxation.

ANTI-AVOIDANCE MEASURES AND POSSIBLE TRAPS [§72 TCA 1997]

Section 72 TCA 1997 is a complex piece of anti-avoidance legislation. The section is aimed at preventing Non-Dom individuals from obtaining loans or overdrafts to meet current expenditures, while at the same time using unremitted foreign earnings to repay loans abroad. In simple terms, the repayment of a foreign loan by a Non-Dom individual out of the proceeds of foreign income may be considered a remittance to Ireland.

Types of transactions that may give rise to a remittance under §72 TCA 1997 include

- foreign income used or provided by a Non-Dom person to repay any loan in Ireland or any interest on such loan, such as an Irish loan repaid by French rental income;
- any loan that was granted outside of Ireland to a Non-Dom person and received in or brought into Ireland, such as a French loan granted to a Non-Dom individual, which is repaid out of French rental income and in turn the proceeds of another loan are remitted to Ireland;
- any debt incurred in satisfying in whole or in part any of the above loans; and
- any foreign loan repaid out of foreign income before the proceeds of the loan are brought into Ireland, such as a French car loan repaid out of French rental income where the car is subsequently sold in France and the proceeds are remitted to Ireland.

GIFT AND INHERITANCE TAX

A foreign domiciled individual who moves to Ireland will come within the Irish gift and inheritance tax net after completion of five consecutive years of residence. The tax exposure begins in the sixth year.

Up to that point, only gifts or inheritances of Irish assets gifted or received by that individual will be liable to Irish gift or inheritance tax, provided that the person who makes the gift or receives the gift is not within the Irish gift or inheritance tax net.

After five consecutive years of tax residence, however, the foreign-domiciled individual will be within the scope of Irish gift and inheritance taxes. This means that

- all gifts or inheritances received are liable to Irish gift or inheritance tax, and
- all lifetime gifts or bequests under a will cause the recipient to be liable to Irish gift or inheritance tax.

The current rate of gift and inheritance taxes is 33% of the value of the assets. Several exemptions exist, notably those for

- spouses, which is a complete inter-spousal exemption not dependent on the domicile of either spouse;
- the first €280,000 per child, which tends to be increased periodically;
- gifts or inheritances of a parcel of real property that is the recipient's main home;
- gifts or inheritances of business property, which qualify for a 90% relief; and
- gifts or inheritances of agricultural land, which qualify for a 90% relief.

"Ideally, a Non-Dom individual should take Irish tax advice before becoming resident in Ireland."

The tax reliefs for gifts or inheritances of a main home, business property, and agricultural property come with certain conditions or restrictions which are outside the scope of this article.

A foreign-domiciled individual can minimize the amount of the estate that comes within the scope of Irish gift/inheritance tax by

- making significant gifts before the beginning of the sixth year, or
- terminating Irish residence.

The threshold period for imposition of gift or inheritance tax is five consecutive years of Irish residence. If a Non-Dom individual limits presence in Ireland during a two-year period, the 280-day test of residence that covers presence over two consecutive years would not be met. Residence would be terminated and a new five-year period would begin.

PLANNING BEFORE MOVING TO IRELAND

Ideally, a Non-Dom individual should take Irish tax advice before becoming resident in Ireland. An individual becomes resident in Ireland on January 1 of a tax year (depending on how many days are spent in Ireland during that year). Consequently, an individual could move to Ireland in April 2016, and spend the rest of the year in Ireland. The individual would be resident in Ireland from January 1, 2016. In that case, the Non-Dom individual must take advice well before the first day of the calendar year in which the move to Ireland occurs. Conversely, if an individual were to move to Ireland on August 1, 2016 (not having spent any previous time in Ireland during the year), he or she would not be Irish resident for 2016. The key date for this person will be January 1, 2017.

The planning that a foreign-domiciled individual should consider prior to taking up Irish tax residence includes several steps:

- Identifying capital accumulated prior to becoming Irish tax resident and placing this capital into a separate, designated bank account or investment account
- Setting up the bank account/investment account containing capital in such a way that any income paid on the capital is credited to a separate account so that remittances can be made to Ireland from the capital account, free of tax

- Setting up separate bank accounts for highly taxed and low taxed income in order to maximize foreign tax credit relief in Ireland upon remittance
- Reviewing an investment portfolio to eliminate any investments that do not qualify for the remittance basis of taxation, such as non-euro currency accounts and certain, primarily European, fund investments
- Reviewing an investment portfolio for purposes of stepping up the base investments in appreciated investments
  - For example, if an investment has been held for 10 years and has a basis of €1,000 but a value of €100,000, it should be sold prior to the establishment of residence in Ireland in order to avoid taxable remittances of the gain. The same investment could be repurchased, increasing the basis to €100,000 prior to the time residence is established. Of course, home country tax rules must be considered before implementing this strategy in order to avoid surprises.
- Assessing future needs for spending in Ireland and future income sources, in order to ascertain the most tax efficient ways of funding spending in Ireland
  - Generally, the best way to fund spending in Ireland is through a mixture of remitting accumulated capital prior to becoming Irish resident (which is not taxable), and foreign income (which is taxable if remitted to Ireland, but at lower levels may be covered by personal allowances or taxed at low rates). It is generally preferable to bring in a small amount of income and a small amount of capital each year in order to preserve the individual's capital, rather than living purely from capital in the first number of years and then finding that large amounts of income must be remitted in later years once capital has been exhausted.
- Gifting assets to children or other family members prior to becoming Irish tax resident or within the first five years of Irish tax residence
- Taking advantage of differences in residence status between spouses, such as where one spouse may be Irish resident while the other is nonresident
  - This could occur, for example, if significant business travel by one spouse delays the start of Irish residence. If there are differences in residence/domicile position between spouses, perhaps assets should be transferred from one spouse to the other in order to maximize the tax position.

CONCLUSION

In conclusion, Ireland offers the opportunity for foreign-domiciled individuals to assume tax residence in a country where little or no income tax is imposed. Ireland has a number of benefits for foreign-domiciled individuals which include

- remittance basis for non-Irish source income;
- remittance basis for non-Irish source gains;
- gift and inheritance planning possibilities for Non-Dom individuals;

- a common law system, so there is no difficulty in recognizing existing trust structures;
- access to all E.U. Tax Directives by virtue of being an E.U. member state;
- an extensive double tax treaty network;
- clear rules on how to become and cease to be tax resident;
- low rates of stamp duty on residential property purchase – 1% up to €1 million and 2% thereafter; and
- good international air links.

Ireland is currently named as the best country in the world by the Good Country Index and was rated by Forbes as the best place in the world to do business in 2013.

THE *FORFAIT* TAX REGIME IN SWITZERLAND – A VENERABLE ALTERNATIVE

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Tags
Forfait
Non-Dom
Switzerland

INTRODUCTION

For decades, Switzerland has had a favorable regime in place for non-Swiss nationals. Known as the "*forfait* taxation regime," the special rules allow foreign nationals relocating to Switzerland to pay tax on their worldwide expenditures, subject to an annual minimal base payment.

The forfait taxation regime is often mentioned as being comparable to the U.K. and Irish non-domiciled ("Non-Dom") tax regimes. However, when coupled with other advantages of the Swiss tax system, the forfait taxation regime is thought by many tax advisers to be more advantageous on several counts. First, it has a long history and is expected to continue as a result of a Federal referendum in 2014. In addition, there is usually no inheritance tax on transfers between spouses and to descendants.

Forfait taxation is available in most cantons, including Geneva, Vaud, Berne, Schwyz, Zug, and Grison in particular. However, Zurich and Basel have abolished the regime in recent years. While the prognosis for the forfait taxation regime is good, certain changes are anticipated. For example, the forfait legislation will be subject to somewhat increased thresholds from 2016 on, as discussed later in this article. Nonetheless, the basic principles will remain unaltered.

ELIGIBILITY

The forfait taxation regime is available to foreign nationals taking up tax residence in Switzerland for the first time. It is also available to returning (non-Swiss) residents who have resided outside of Switzerland for at least 10 years. Dual citizens do not qualify if one of the nationalities is Swiss.

Although the regime was originally aimed at wealthy foreigners retiring in Switzerland, there has never been a minimum age. However, to claim the benefit of the forfait taxation regime, an eligible individual must not exercise any paid work in Switzerland. This covers work as an employee and as a self-employed individual. Because this limitation pertains to work performed in Switzerland, work activity wholly performed abroad is permitted. This suggests that the individual must commute to an office outside of Switzerland, and consequently, tax may be imposed in the country where personal services are performed.

Beginning in 2016, both spouses must fulfil all the above criteria. Until then, the non-Swiss spouse in a mixed nationality couple could indeed apply for a forfait. That is no longer an option.

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CALCULATION OF TAX

Forfait taxation is based on one of three tax bases: (i) the taxpayer's worldwide living expenses, (ii) the control computation, or (iii) the minimum amount. Whichever base produces the highest amount is the tax base that will be used. Ordinary tax rates are applied to the base that is chosen.

The forfait tax base corresponds to the cost of maintaining a family. Cantons have considerable leeway in determining the practical aspects of what is included. In broad terms, living expenses include the cost of accommodation, general living, cars, aircraft, yachts, housekeeping, and personnel costs for all individuals financially supported by the taxpayer. This amount is computed by multiplying the rent paid for the living premises of the individual by a factor, which typically is a seven-times multiplier.

"Forfait taxation is based on one of three tax bases: (i) the taxpayer's worldwide living expenses, (ii) the control computation, or (iii) the minimum amount."

Once the forfait tax base is computed, the so-called control calculation or shadow calculation must be taken into account. The control calculation includes in taxable income all items of Swiss-source income such as dividends from Swiss shares, royalties or interest from Swiss sources, and Swiss real property rental income. A portfolio of non-Swiss shares held and managed by a Swiss bank is excluded from the control computation. In addition, income for which treaty benefits are claimed must also be included. Treaty-protected income typically includes non-Swiss dividends and royalties subject to a withholding tax in the source country. This allows a taxpayer claiming the benefit of the forfait taxation regime to benefit from reduced withholding tax abroad.

Finally, a minimum amount of income is computed. From 2016 on, the minimum tax base is CHF 400,000 and a taxpayer's overall wealth will be taken into account. Cantonal practices are expected to vary considerably in this respect.

By way of example, a taxpayer with a monthly rent of CHF 5,000 will have a tax base of CHF 420,000 (*i.e.*, CHF 5,000 x 12 months x a multiplier of 7) based on living costs. With a monthly rent of CHF 3,500, the tax base will be (i) the minimum amount of CHF 400,000, as the living expense calculation (CHF 3,500 x 12 months x a multiplier of 7 = CHF 294,000) is below minimum of CHF 400,000, or (ii) the control amount based on Swiss-source income (such as dividends, interest, royalties, rental income) and income for which treaty benefits are claimed (*e.g.*, non-Swiss dividends). Tax payable is calculated by application of the ordinary progressive tax rates to the agreed tax base.

CANTONAL AND COMMUNAL RATES VARY

Switzerland, despite its relatively modest size, has 26 cantons that are further subdivided into approximately 2350 local communes. Tax is levied at Federal, cantonal, and communal levels. A forfait is negotiated with the cantonal authority, and the tax base to which ordinary tax rates apply is determined in those negotiations.

In Switzerland, the rates vary by canton and commune. The overall maximum tax rate will generally be between 25% and 45%, depending on the canton and commune in which the individual resides.

To illustrate, a married taxpayer with two children and a tax base of CHF 600,000 would pay tax approximately in Geneva, Lausanne, Gstaad, and Klosters as follows (with wealth tax not yet taken into consideration).

Place of Residence	Approx. Tax Payable
Geneva	CHF 225,000
Lausanne	CHF 225,000
Gstaad	CHF 200,000
Klosters	CHF 180,000

Given the wide range of applicable tax rates in Switzerland, there is considerable scope for "geographical tax planning." Although there is a statute harmonizing taxes among cantons, there are considerable differences in how the authorities apply the law in practice. Cantons and communes have strongly differing tax rates. Consequently, if an individual lives on a cantonal or communal border, the tax rates can vary significantly on each side.

Often, the sophistication of the canton and commune is balanced against the applicable tax rate. As a rule of thumb, remote cantons offer reduced taxes. If all that matters is the need to pay as little tax as possible, an individual will look at the communes with the lowest rates and the most favorable local practices regarding the tax base. Inheritance tax is also imposed at the cantonal level and varies significantly among the cantons.

Typically, a client will have an idea of where he wants to live (in the city, mountains, or somewhere in between) and the adviser will then make a few suggestions. The choice is to a limited extent narrowed by the fact that a few cantons have abolished the regime – most notably Zurich.

"Earlier this year, Switzerland held a national referendum regarding the imposition of inheritance tax on the Federal level at a uniform rate of 20%. Over 70% of the voters disapproved of the proposal."

APPLICATION OF TAX TREATY WITHHOLDING TAX RATES

As mentioned above, any income for which treaty benefits are claimed will be included in the so-called control calculation. In addition, some income tax treaties will not accept a forfait taxpayer as tax resident if the income from that country benefits from the forfait tax regime. In particular, the income tax treaties with Germany, Belgium, Norway, Italy, Austria, Canada, the U.S., and France provide that benefits are dependent on full Swiss taxation of income that is sourced in those countries. Not all treaty provisions are identical, and in particularly, in relation to France there is uncertainty in practice as to the treatment of French-source income.

With regard to each of the foregoing countries, treaty tax benefits are applied to a Swiss resident on a per-country basis only if all items of income from that country are reported on a Swiss tax return and taxed under Swiss rules generally applicable to Swiss residents. As a result, the entire income of the individual derived from a given country within this group must be included in the alternative computation of the tax base. Swiss tax is computed on the sum of the designated Swiss income and the income from those countries. Again, the tax is the greater of the tax on the consumption base or the control base. Consequently, if the consumption base exceeds the sum of the control base and the treaty-country income, the tax on the consumption base is applicable.

INHERITANCE TAX

Earlier this year, Switzerland held a national referendum regarding the imposition of inheritance tax on the Federal level at a uniform rate of 20%. Over 70% of the voters disapproved of the proposal. Inheritance tax remains a matter for the cantons to decide.

All cantons offer full spousal exemption. In the vast majority, both lifetime and death transfers to descendants are not subject to tax. Vaud levies inheritance tax on transfers to children, and so does Geneva if the deceased is subject to the forfait taxation regime. Registered same sex partners are exempt, too.

Transfers to unrelated donees or heirs may be subject to gift tax or inheritance tax imposed at rates of up to around 40% (depending on the canton).

The canton of Schwyz (which is German speaking) has no inheritance tax whatsoever.

SOCIAL SECURITY TAX

Forfait taxpayers under the age of 65 are subject to social security contributions. Depending on an individual's wealth, the contribution may amount to as much as CHF 24,000 plus an approximate 5% administrative cost per person.

GRANDFATHERED PROVISIONS

The new rules, which will come into force from January 1, 2016, will not fundamentally alter the application of the forfait taxation regime. Instead, they will essentially codify what has been practice in many cantons for some time. The new rules contain the following provisions:

- They provide for a minimum tax base at the Federal level of CHF 400,000 or seven times the actual or deemed rent.
- They provide that an applicant's overall wealth must be taken into account.
- They require that both spouses must fulfill the criteria for eligibility. (Consequently, mixed-couple forfaits involving Swiss and foreign nationals will no longer be permitted.)

Existing forfait rulings will remain valid for a transition period of five years.

OBTAINING A FORFAIT

Obtaining the forfait is usually less of an issue than immigration, especially for non-E.U. nationals. Once the residence canton and commune of choice have been identified, an eligible individual typically approaches the local cantonal tax authorities. Such authorities are competent to grant a forfait ruling.

When discussing a forfait with the cantonal tax authorities, information on an individual's worldwide living expenses and an approximation of wealth must be provided. The level of detail requested by the authorities varies greatly between cantons. If the relevant information is provided in a forthright manner, a ruling may be issued within two weeks.

IMMIGRATION RULES

The relevant criterion is nationality; the relevant distinction is between E.U. and non-E.U. nationals. Nationals of the 28 E.U. member countries are entitled to a residence permit, provided they are in a position to finance their living expenses and take out valid health insurance within three months from immigration.

The procedure is somewhat more burdensome for a non-E.U. national. Such individuals must either (i) be able to demonstrate a particular connection to Switzerland, such as childhood or holidays regularly spent in Switzerland, family members resident in Switzerland, or education in Switzerland; (ii) be over 55 years old; or (iii) qualify for a "statutory exemption." Statutory exemptions may cover individuals with cultural backgrounds or who make fiscal investments. The latter is essentially comparable to what is often called an "investor visa" in other countries.

Non-E.U. nationals may also seek a permit for education or medical reasons, but that would be relevant in a forfait tax context only if the stay were for an extended period.

An applicant's family will normally be granted the right to accompany the visa applicant.

FORCED HEIRSHIP RULES

Foreign nationals may provide for their estates to be governed by the law of their nationality, thus getting around the Swiss forced heirship rules. In some instances, it will be necessary to consider the E.U. Succession Regulation, a full discussion of which is outside the scope of this article.

PURCHASES OF REAL PROPERTY

The right to purchasing real estate is independent of an individual's tax status. The same rules apply to forfait and ordinary taxpayers. E.U./E.F.T.A. nationals who are Swiss resident are not subject to any restrictions limiting the right to own real property. A so-called Lex Koller-permit will be required, however, for the acquisition of a holiday home by nonresidents.

Non-E.U./E.F.T.A. nationals with a permanent residence permit ("C permit") are not subject to Lex Koller-restrictions either. Non-E.U./E.F.T.A. nationals with an ordinary residence permit ("B permit") are entitled to purchase their primary homes without a

Lex Koller-permit. The purchase of a second home such as a holiday home requires the issuance of a Lex Koller-permit.

A holiday apartment passed on by family inheritance will not be subject to the Lex Koller-permit requirement.

In addition, there is so-called second home legislation that applies regardless of Swiss, E.U./E.F.T.A., or other nationality. This legislation restricts the quota of holiday homes in to 20% per commune.

CONCLUSION

In conclusion, Switzerland's venerable forfait taxation regime is alive and will remain so in the future. For the right individual, who lives in a canton and commune with favorable rules, the forfait remains an excellent alternative to Non-Dom status in the U.K. – all the more so for long-term Non-Doms affected by new rules in the U.K. limiting Non-Dom taxation to 15 years.

SPANISH TAX REGIME FOR INCOMING PROFESSIONALS

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Tags
Beckham Law
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Pre-Immigration Planning
Remittance Basis
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Tax Residency

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INTRODUCTION

In Spain there is an advantageous tax regime available for incoming professionals. While an individual who benefits from the regime will be deemed tax resident in Spain, the tax is limited in two ways: (i) the tax base consists only of Spanish source income and (ii) a special tax rate of 24% is applied to that income. Foreign-source income will not be subject to tax in Spain regardless, even if remitted to Spain.

BACKGROUND TO THE BENEFICIAL TAX REGIME

It was in the last days of 2003 when a new tax regime was created for qualifying immigrant professionals in Spain. This new regime was not subject to further development and was put aside until the year 2005, in which new implementation rulings were issued and the system became viable.

Technically, the beneficial tax regime was designed as a temporary measure for incoming professionals, such as football players – read "soccer" in U.S. It was used to attract well-known football celebrities to play for Spanish clubs, and as a result, the law was nicknamed "the Beckham Law." European football clubs normally agree to bear the players' personal tax burden. Hence, any system that reduces the tax on players constitutes significant aid to the clubs, not the players themselves, and allows the clubs to hire the best players under better salary conditions. Today, this nickname is so well known that it has even been referred to as the "Beckham Law" on Wikipedia.

The regime is automatically granted, provided that conditions are met and the election for coverage is properly filed. This special tax regime has been used by a significant number of foreign professionals and sportsmen coming to Spain on a temporary basis in recent years. Some small changes have been made to the regime since it was created, but the core remains unchanged.

REQUIREMENTS FOR COVERAGE

In order to be able to apply for this special tax regime, the following requirements must be met:

- The individual must not have been tax resident in Spain in the preceding ten years.
- The motivation for coming to Spain should be one of the following:

- ○ The individual has an employment contract in Spain, which can either be (i) a new contract from a Spanish company or a Spanish branch of a foreign entity, or (ii) a secondment to Spain from a foreign employer, but always within a labor relationship
- ○ The individual has been appointed as administrator (director) of a company that is not considered for tax purposes to be a related party to the individual (the company would be a related party if the administrator held, directly or indirectly, more than 25% of the capital or voting rights of the company)

- The individual does not obtain income in Spain that would be considered as obtained through a permanent establishment in Spain.

The first requirement is factual. No comment is required. The third requirement applies only in exceptional cases in which the individual could be deemed a dependent agent of a foreign company following the definition of permanent establishment included under Article 5.5 of the O.E.C.D. Model Income Tax Treaty.

The second requirement deserves comment. The special regime is limited to professionals covered by a labor contract or performing administrative duties as directors of companies in which they do not maintain control. The typical case would be of a managing director in a big corporation who is not technically an employee but is treated as such for these purposes. This excludes entrepreneurs or company owners, unless they were hired by a different company, not related to the individual's company or business. In fact, under social security law, an individual who owns or controls a company, as measured by 25% ownership of capital or voting rights, cannot be considered to be an employee of the company. The existence of an employment contract between the company and the shareholder owning 25% or more will not change the result.

In the author's experience, this requirement is not easily met in many cases. For individuals caught up by the control exclusion, arrangements must be explored to address the problem, possibly by transfers of ownership or limitations on voting rights.

TAXATION UNDER THE SPECIAL REGIME

Application Process

The incoming professional who meets the above requirements may file an application with the Tax Office requesting his entitlement to the special regime. The initial period of coverage runs from the financial year in which the application is filed through the next five financial years. The application is submitted on Form 149. It should be accompanied by

- personal identification;
- the labor contract or a secondment letter, whichever is applicable;
- a social security registration certificate; and
- any other documents that prove the accomplishment of the legal requirements.

Once the application form is filed by the individual, the Tax Authority has ten business days to answer. As mentioned above, the Tax Authority has no discretion to withhold the benefits of this regime. Instead, it will issue a letter acknowledging the receipt of the application and the terms and conditions under which the regime will apply for the current year and the following five years.

The Tax Regime

The benefits of the regime are relatively straightforward.

- *Tax Rate*: The incoming professional will be tax resident in Spain but will be taxed as a nonresident. As discussed below in greater detail, the tax base is limited to Spanish-source income. For the first €600,000 of Spanish-source income, the special tax rate for nonresidents is applicable. It is a flat 24%. The tax on amounts in excess of €600,000 is imposed at standard tax rates. This is in itself a substantial advantage, since the marginal individual tax rate in Spain is 46% for 2015 and the rate for 2016 is scheduled to be 45%.

  For savings income, including interests, dividends, and capital gains obtained in Spain, the tax rate is 20% for the first €6,000, 22% from €6,000 to €50,000, and 24% for amounts in excess of €50,000. Each of these rates will be reduced by one percentage point in 2016.

- *Residence Certificate*: Because the beneficiaries of this regime are resident in Spain for income tax purposes, they benefit from E.U. taxation principles. In principle, tax treaties signed by Spain should be applicable to beneficiaries of this regime. However, there may be other views; each treaty is unique and should be reviewed carefully. In addition, it may be more difficult for an individual benefitting from this regime to obtain a tax residence certificate from the Tax Authority. A limited review of the situation may be required before a certificate is issued.

- *Tax Base*: Only Spanish-source income is subject to taxation. This will include salary income or directors' fees, and any other income from Spanish sources. All employment income or directors' fees will be deemed to be obtained from sources in Spain no matter where they were obtained from or paid from prior to arrival. Other income or gains obtained outside of Spain would not be subject to Spanish taxation.

- *Other Taxes*: Beneficiaries of this special regime will be subject to Spanish wealth tax only on wealth located in Spain. Incoming professionals will not have special inheritance tax protection while they are resident in Spain. In this regard, pre-immigration planning for temporary residence in Spain is highly recommended.

"The Tax Authority has no discretion to withhold the benefits of this regime. Instead, it will issue a letter acknowledging the receipt of the application and the terms and conditions under which the regime will apply for the current year and the following five years."

COMPARISON WITH OTHER SIMILAR REGIMES

This beneficial tax regime for professionals has similarities to special tax systems of countries that impose tax on a territorial basis rather than on a worldwide income basis. Examples include the remittance basis taxation regime in the U.K. and the nonregular resident regime in Portugal.

- *U.K. Remittance Basis Regime*: This is a regime that is enjoyed by persons who are not domiciled in the U.K. but are tax residents, nonetheless. The remittance basis regime is currently in effect, but it is scheduled to be terminated in 2017 for those who will have been resident for 15 years. Several important differences exist between the U.K. regime and its counterpart in Spain.

  - Remittances to Spain from abroad are totally irrelevant for Spanish tax purposes. Whether the remittance comes from income, gain, capital, or loans, the remittance is not taxed so long as it is deemed to arise from sources outside of Spain.

  - Spain will deem all salary income or directors' fees as Spanish-source income regardless of the location where services were performed or the location of the payroll used to compensate the individual. As a result, all such compensation is taxable in Spain.

  - The period of time under which benefits are allowed under the Spanish regime is five years plus the year of arrival.

  - The U.K remittance basis regime does not create a special tax rate for U.K.-source income; all income that is taxed is exposed to ordinary graduated rates of tax, rather than a 24% tax rate.

- *Portuguese Nonregular Resident Regime*: The tax exemption on foreign-source income is conditioned upon the fact that such income has been or can be subject to taxation abroad. Portuguese-source income is taxed at the rate of 20%, and the regime can be obtained for up to ten years.

IMMIGRATION ISSUES

In order to qualify for the special regime, the individual must be tax resident in Spain. Although the principles of tax residence do not match those of the immigration law, an individual wishing to benefit from this special tax regime must comply with Spanish and European immigration rules. If not an E.U. citizen,[1] an applicant must obtain a residence visa and a work permit. Work permits are not difficult to obtain for top management positions and for employees sent on a secondment position within a multinational group. A work permit for a standard position may be difficult to obtain, and the applicant may have to prove that his or her professional skills are not available from other candidates within Europe.

CONCLUSION

The Spanish special tax regime for incoming individuals can be an interesting alternative for professionals willing to come to Spain within the framework of a labor relationship or director's mandate. The individual will be considered tax resident in Spain, but only Spanish-source income would be subject to tax at the flat rate of 24% for up to €600,000 of income. Foreign-source income and gain would not be taxable in Spain. These benefits are enjoyed for the year of arrival and the following five years.

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[1] Citizens of Switzerland are included.

WHAT IS THE FUTURE FOR NEW IMMIGRANT BENEFITS?

Authors
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Tags
Alya
Israel
New Immigrant Benefits
Reporting Requirements

In 2008, the Knesset Committee for Immigration Absorption passed Amendment 168 to the Income Tax Ordinance [New Version] 5721-1961, granting a favorable tax regime to new immigrants and returning residents to Israel (the "New Immigrant Benefits"). The move to Israel is often referred to as *Alya*. The purpose of the reform was to encourage immigration to Israel from wealthy countries while providing new immigrants with a period of time to organize tax structures in an efficient way.

The New Immigrant Benefits rules were adopted with the support of the Israeli Tax Authority. The rules became effective for new immigrants who arrive in Israel on or after January 1, 2007.

TAX INCENTIVES

Liberalization of Israel's Economy

Promoting immigration by granting favorable financial and tax treatments in a country that was built through immigration was not an obvious matter. It reflects the liberalization of the Israeli economy.

The first step occurred in May 1998, when a major change took place in the Israeli foreign currency regulations. The new regulations allowed Israeli residents to have foreign currency accounts outside of Israel and to buy, sell, and own property abroad. The reform was revolutionary because at this time, Israeli residents were taxed only on Israeli income. This changed on July 24, 2002, when the Knesset approved an amendment to the Income Tax Ordinance abolishing the territorial principle of taxation under which the tax base was limited to income accrued or received in Israel. The new legislation introduced the principle of personal global taxation, meaning that Israeli residents were subject to tax on worldwide income.

In the same period, New Immigrant Benefits were introduced for a period of four to five years depending on the nature of the income. The new rules were effective from January 1, 2003. Foreign business income was exempt for four years while non-business income such as passive income was exempt for five years. In addition, new immigrants were exempt from capital gains tax on the sale of assets located outside Israel that were in their possession prior to arrival. The exemption lasted for a period of ten years from arrival.

Taxation of Israeli Residents

Determining the point when Israeli tax residence begins is not an easy task. In many instances, individuals spend significant time in Israel where they may own a leisure home or where family members reside. It is not uncommon for these persons to

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create professional ties with Israel before deciding to leave their home countries. These visits and ties grow incrementally over a period of many years and may be quite strong prior to the time when a more formal transfer of residence occurs.

Israeli tax residence is based on an individual's personal facts and circumstances. An individual is considered an Israeli resident for income tax purposes if the center of life is in Israel. Case law lists a number of indicators used to determine the individual's center of life:

- The place of the individual's permanent house
- The place where the individual and his or her family live
- The individual's regular or permanent place of business or employment
- The individual's place of vital and active economic interests
- The place in which the individual is active with regard to various organizations, unions, or institutes[1]

"Determining the point when Israeli tax residence begins is not an easy task. In many instances, individuals spend significant time in Israel where they may own a leisure home or where family members reside."

These are "touchy/feely" standards and no single factor, by itself, is controlling in all circumstances.

In addition to the above tests, an individual is presumed to be an Israeli resident if presence in Israel exceeds a specific number of days. This is known as the "days test."

Currently, Israeli residents are subject to personal income tax at progressive rates of up to 48%. In addition, a special tax of 2% is imposed on any income above NIS 800,000. Passive income such as financial portfolio income is taxed at reduced flat rates, usually 25% to 27%.

BENEFITS PROVIDED UNDER THE 2008 REGIME

A Broad Definition of New Immigrants

The New Immigrants Benefits regime applies to two main categories of individuals:

- A "first time Israeli resident," *i.e.*, an individual that becomes an Israeli resident the first time
- A "veteran returning resident," *i.e.*, a former Israeli resident who returns to Israel after a period of at least ten years of foreign residence

First time Israeli residents and veteran returning residents will be referred to as "New Immigrants." New rules apply to these individuals. At the same time, scaled-back tax benefits apply to individuals who were Israeli residents at one time and have returned to Israel after being abroad for between six and ten years. These persons are referred to as "Regular Returning Residents."

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1 However, such test should not be considered as being definitive.

Main Features of the New Immigrant Benefits

The main features of the New Immigrant Benefits are as follows:

- *Exemption for Foreign Source Income and Capital Gains*: New Immigrants are exempt from tax on foreign-source income for a period of ten years. This exemption applies to earned income and passive income. Capital gains arising from non-Israeli assets or shares in an Israeli company acquired while the individual was a foreign resident are exempt from Israeli capital gains tax for the same ten-year period. Following the exemption period, the portion of any gain derived from a sale of the assets continues to be exempt from tax to the extent attributable to the holding period, beginning on the date of acquisition and running to the end of the ten-year exemption period. The exemption is calculated on a linear basis so that the days in the exempt holding period are divided by the total days in the entire holding period; the resulting percentage is applied to the gain.

- *An Exemption on Reporting Foreign Source Income*: New Immigrants are exempt from reporting their non-Israeli-source income, gains, and assets.

- *Exemptions Provided to Companies Held by the New Immigrant*: Foreign companies, held by New Immigrants will not be considered managed and controlled from Israel merely because of the immigration of a New Immigrant owner to Israel. Again, this benefit lasts for a period of ten years from immigration. In the same way, New Immigrants are not considered Israeli residents in respect of the C.F.C. legislation during the exemption period. Lastly, New Immigrants are not subject to the Foreign Occupation Company regime.

- *Entitlement to an Adjustment Period Election*: Within 90 days from the date of arrival, a New Immigrant can elect to defer Israeli tax residence for a period of one year from the actual arrival date in Israel. In such circumstances, he or she will not be issued a residency certificate from the Israeli Tax Authorities.

These exemptions apply only to income generated abroad. As a consequence, if a New Immigrant works from Israel for a foreign company, the Israeli activity may likely create a permanent establishment in Israel for the company. The profits allocated to the permanent establishment will be taxable in Israel. In addition, a New Immigrant will be subject to tax on the working days in Israel.

Main Features of Limited Benefits to Regular Returning Residents

Regular Returning Residents are tax exempt on income generated by assets purchased during the period of foreign residency. These include

- a five-year exemption for (i) passive income derived from assets acquired during the nonresident period, (ii) interest and dividend income derived from "preferred securities," which are securities traded on foreign exchanges that have been purchased during the nonresident period, and (iii) income from other securities that have been purchased with proceeds of an exempt sale when the proceeds are place in a "closed bank account;" and

- a ten-year exemption for capital gains from the same assets, provided that they do not represent a right to an Israeli asset.

CERTAIN ADVERSE CONSEQUENCES

While the New Immigrant Benefits generally provides attractive tax rules, certain adverse consequences may result in a specific set of circumstances.

Entitlement to the Treaty Benefits

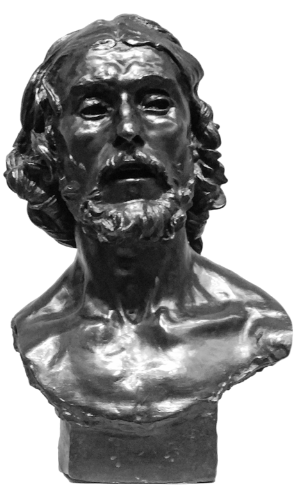
It is not unusual to encounter tax treaties that define a resident of a treaty jurisdiction as a person who is subject to tax on worldwide income by that jurisdiction. Examples include income tax treaties between Israel and Switzerland, Germany,[2] Spain, and France. In such circumstances, the tax treaty does not apply to a New Immigrant who benefits from the New Immigrant Benefits. In some circumstances, the withholding tax in these countries can exceed the Israeli tax imposed on residents, generally.

Residency Certificate for New Immigrants

In many situations, tax authorities require that a residence certificate be furnished prior to the time that a withholding agent makes payment to a resident of a treaty jurisdiction. Without the certificate, tax must be withheld as if the treaty does not exist. In other situations, financial institutions demand residence certificates for compliance requirements under applicable know-your-customer rules or anti-money-laundering rules.

The Israeli Tax Authority has a strict policy regarding the issuance of residence certificates for New Immigrants. The reason is that the Israeli Tax Authority wishes to avoid situations where an individual takes advantage of the New Immigrants Benefits without actually transferring the center of life to Israel. Strong supporting evidence is required indicating presence in Israel for at least 143 days over a period of years before a residence certificate will be issued.

INFORMATION REPORTING – FLASHPOINT



Although tax exemption regimes exist in other countries, the New Immigrant Benefits has been repeatedly criticized for the information reporting exemption that is provided to New Immigrants. Both the O.E.C.D. and Israel's trading partners insist that Israel should comply with the current international trend towards transparency and exchange of information. The O.E.C.D.'s Global Forum on Transparency and Exchange of Information for Tax Purposes recently underlined that the reporting exemptions granted to New Immigrants are not compatible with current O.E.C.D. objectives.

Accordingly, it is expected that Israel will amend the Income Tax Ordinance as a result of the pressure for information transparency. In that regard, the Israeli Tax Authority and the Israeli government have suggested eliminating the ten-year reporting exemption on foreign income and gains that is currently available to New Immigrants. While these initiatives have not yet succeeded, many believe that it is only a matter of time until the exemption from reporting is eliminated. Note that even if information reporting is required, the tax exemption regime will remain in effect.

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[2] See the May 21, 2014 version, not yet ratified.

PORTUGAL: A RACE TOWARDS TAX COMPETITIVENESS – THE NON-HABITUAL TAX RESIDENT REGIME

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Golden Visa
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Portugal
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INTRODUCTION

In recent years, Portugal has introduced several measures that aim to promote foreign investment and the relocation of wealthy or highly-qualified individuals to Portugal. In this context, two new programs entered into force: (i) the Golden Visa, which is a temporary residence permit granted to foreign individuals who make an eligible investment in Portugal, and (ii) the Non-Habitual Tax Resident ("N.H.T.R.") regime, which is a more favorable tax regime granted to individuals moving to Portugal.

The purpose of this article is to address the main features of the new programs and to highlight the main planning opportunities that may arise for an individual wishing to become an N.H.T.R.

THE GOLDEN VISA AND THE NON-HABITUAL TAX RESIDENT REGIME

The Golden Visa

A non-E.U. citizen may only change residence to Portugal if a residence permit (or visa) is obtained. There are several types of available visas, such as student visas, entrepreneurs' visas, or work visas. In many instances, a non-E.U. citizen may encounter difficulty in obtaining a proper visa or may not meet the underlying requirements to obtain a visa.

To remedy this perceived issue, the Portuguese government introduced the Golden Visa[1] program, which grants a temporary residence permit to non-E.U. citizens making investments in eligible activity in Portugal. The law provides for several types of investment activities:

- Transference of capital into Portugal, in an amount equal to or higher than €1 million
- Creation of at least ten jobs
- Acquisition of real estate property in a minimum amount of €500,000.00

Recently, the list of investment activities was extended to include the following situations:

[1] Pursuant to article 90.º-A of Law No. 23/2007, of July 4 (Immigration Law).

- Transference of capital in an amount that is at least €350,000.00 to be used in scientific research activities conducted by public or private institutions that are part of the national scientific system
- Transference of capital in an amount that is at least €350,000.00 to be invested in or to support artistic productions or to maintain Portuguese cultural heritage
- Transference of capital in an amount that is at least €500,000.00 to be used in the purchase of real estate that is part of urban reconstruction

If the investment is conducted in places considered to be low-density areas, the minimum amount of required investment is reduced by 20%. Investments may be made directly by an individual or through a single-person limited company wholly-owned by the individual.

The Golden Visa is granted for five years and gives its holder the right to enter, live, and work in Portugal, provided that the stay in Portugal equals or exceeds seven days in the first year and 14 days in subsequent years. It also allows the holder to move freely within the Schengen area. Once granted, a Golden Visa gives its holder's family the right to obtain a residence permit without making any further investment, provided that certain conditions are met. Family members include: (i) the spouse, (ii) minor or disabled children, (iii) economically dependent adults, and (iv) parents. In addition, the holder of a Golden Visa may obtain a permanent residence permit and may apply for Portuguese citizenship, provided that certain conditions are met.

"Once granted, a Golden Visa gives its holder's family the right to obtain a residence permit without making any further investment, provided that certain conditions are met."

To apply for a Golden Visa, a non-E.U. citizen must file a request together with all the relevant documentation, such as a passport, evidence of legal entry into Portugal, health insurance, authorization allowing the Portuguese authorities to seek information regarding a possible criminal record, and proof of the eligible investment made.

The Non-Habitual Tax Resident Regime

E.U. residents wishing to move to Portugal and non-E.U. residents that have obtained a visa can apply for the N.H.T.R. regime. The N.H.T.R. regime establishes favorable tax treatment for individuals wishing to move to Portugal. It provides an exemption for foreign-source income and lower flat tax rates on Portuguese-source employment and self-employment income, provided the income arises from high value added activities.

To qualify for the N.H.T.R. status, an individual must meet the following tests:

- *Residence Criteria*: The individual must spend more than 183 days in Portugal in a 12-month period, beginning or ending in a given year. Alternatively, the individual must have a house available with regard to which the individual maintains an intent to occupy as a habitual abode on all days of presence in the 12-month period.
- *No Prior Residence Criteria*: The individual must not have been deemed a Portuguese tax resident under Portuguese domestic law and a double taxation treaty, if applicable, or must not have been taxed as a Portuguese tax resident in the preceding five years.

The main goal of this regime, introduced in 2009,[2] is to attract highly-qualified individuals and wealthy individuals to Portugal. In recent years, it has proven a success. When introduced, the N.H.T.R. regime required proof of residence outside of Portugal in the preceding five years. This required an individual to obtain residence certificates issued by tax authorities in other countries and proved to be cumbersome. For that reason, the procedures were simplified[3] and currently provide that an individual wishing to apply for the N.H.T.R. regime need only present a sworn statement evidencing that tax residence in Portugal did not exist during the preceding five years. Naturally, if the tax authorities question the veracity of the statement, the individual must demonstrate that taxes were paid as a tax resident in another jurisdiction during the entire five-year period.

The Portuguese government has published a list of the activities that qualify as "high value added activities of a scientific, artistic or technical nature."[4] Included are activities of

- auditors,
- medical doctors,
- engineers,
- teachers,
- investors,
- directors, and
- managers.

The employment or self-employment income derived from one of the listed activities can be taxed at a flat rate of 20%, if it is deemed to be of Portuguese source. It is exempt if it is of foreign source and is or may be taxed in its state of source in accordance with a double tax treaty entered into between Portugal and the state of source (or the O.E.C.D. Model Convention).[5] This exemption rule can represent attractive planning opportunities for individuals wishing to move to Portugal.

There are several instances where the exemption is allowed even though the income is not subject to tax abroad. One relates to pensions and the other relates to investment income:

- *Foreign Pensions*: Nonresident pensioners who move to Portugal may achieve a full exemption on foreign-source pensions because Portuguese law currently establishes an alternative to the subject-to-tax test. Under the alternative, foreign-source income that is deemed not to be obtained in Portugal can be exempt. When pension income is paid by an entity that does not have a head office or permanent establishment in Portugal, it is not obtained in Portugal.

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2 Decree-Law No. 249/2009, of September 23.

3 Following the publication of Order No. 9/2012.

4 Approved by Ministerial Order No. 12/2010, of January 7.

5 The exception is foreign-source employment income that needs to be effectively taxed in the state of source so as to benefit from an exemption in Portugal.

“The term ‘non-habitual resident’ can be misleading. To benefit from this regime, an individual must be deemed to be a tax resident in Portugal in each year.”

- Foreign Investment Income and Gains: Foreign-source investment income can be exempt if it may be taxed in the state of source, but the tax law in the country of source provides for no effective taxation of the income. Generally, this exemption applies to income from traditional investments generating interest and dividends. It does not apply to other forms of investment income. Portuguese domestic legislation contains a broad definition of the term “investment income.” Included, *inter alia*, are income items arising from

  - swaps,
  - life assurance products,
  - investment certificates, and
  - trust distributions.

  Regarding these latter investments, the understanding is that the exemption does not apply, so it is fundamental for an individual to evaluate and tailor an investment portfolio to become tax efficient under the N.H.T.R. regime or that an efficient ownership structure is put in place.

  The same concern over taxation exists for capital gains from the sale or exchange of movable assets. Most double tax treaties signed by Portugal provide that these gains can be taxed only in the state of residence, which in this case is Portugal. The logical conclusion is that such gains cannot be exempt in Portugal under the N.H.T.R. regime. Again, careful planning is required prior to the establishment of tax residence.

On a final point, an individual qualifying as an N.H.T.R. acquires the right to be taxed under that beneficial regime for a period of ten consecutive years. The term “non-habitual resident” can be misleading. To benefit from this regime, an individual must be deemed to be a tax resident in Portugal in each year.

CONCLUSION

The N.H.T.R. regime, together with the Golden Visa program, are excellent opportunities and incentives for nonresidents wishing to move to Portugal. In addition, Portugal does not have a wealth tax. While Portugal does not have an inheritance tax[6] on lifetime gifts and legacies at death, such transfers are subject to the Stamp Duty Code of 10% plus an additional tax of 0.8% for transfers of real estate.[7] Exemptions from the 10% tax are provided for lifetime transfers of property to a spouse, ascendants (*e.g.*, parents and grandparents), and descendants.

Finally, it should also be noted that Portugal offers other advantages that should not be disregarded, such as good weather, beautiful landscapes, great food, and welcoming people. For these reasons, coupled with the tax incentives described, Portugal has received in the recent years a significant number of N.H.T.R. applications. According to the data made available to the public, Portugal received 1,078 N.H.T.R. requests in 2013, and the number of requests is believed to have increased in 2014 and 2015.

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6 The newly appointed Portuguese government has disclosed plans to revisit the inheritance tax model, but it is uncertain to what extent it may change.

7 Stamp duty is a territorial tax, meaning that tax will only be levied on the assets deemed to be located in Portugal. Moreover, direct family benefits from a stamp duty exemption. The tax rate for donations and mortis causa transfers that are not exempt is 10%.

CONGRESS ENACTS SWEEPING NEW PARTNERSHIP AUDIT RULES

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Tags
Audit
Corporate Tax
Partnerships
Partnership Tax

Partnerships owning real estate or other assets sometimes take aggressive tax positions that may invite I.R.S. scrutiny.[1] However, I.R.S. efforts to challenge such positions are hampered by the fact that the partnership itself is not the taxpayer.

Back in 1982, Congress enacted the Tax Equity and Financial Responsibly Act ("T.E.F.R.A."),[2] which provides for a unified partnership audit. However, the I.R.S. must still assess any resulting tax deficiency against each partner, which becomes increasingly difficult when the number of partners becomes significant. In the recently enacted Bipartisan Budget Act of 2015 (the "Act"),[3] Congress updated the partnership audit rules for all partnerships so as to allow for a unified partnership audit for any partnership, as well as collection of any resulting tax deficiency from the partnership.[4] While the new law will take effect for partnership taxable years starting on or after January 1, 2018, planning should begin now in order to determine the full impact of the new law and what steps may be taken to reduce any adverse consequences.

BACKGROUND

A partnership is an odd creature under the tax law: It resembles a business "entity" in that it files a partnership tax return on Form 1065 and makes certain elections, but it also resembles an "aggregate" of separate partners who each have to file their own tax returns and either pay tax on their shares of the partnership's income or report their shares of partnership loss. For the I.R.S., this entity/aggregate distinction has caused concern on audits of partnerships. Until 1982, the I.R.S. had to audit both the partnership and each partner, individually, in order to assess a tax deficiency against each partner. The resulting administrative burden made partnerships far less susceptible to audits as compared to corporations or individuals.

In 1982, Congress adopted T.E.F.R.A. to respond to this concern. The heart of T.E.F.R.A.'s unified partnership audit rules is Subchapter C (Tax Treatment of Partnership Items) under Chapter 63 (Assessment) of the Code, which encompasses Code §6221 through §6234. The key ingredients of these rules lie in Code §6221, which provides that the tax treatment of any partnership item is determined at the partnership level, and Code §6222(a), which requires all partners to report their

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1 For example, partnerships may try to deduct expenses that are not properly deductible or a partnership may specially allocate tax losses to one partner, which tax allocations lack substantial economic effect under Code §704(b) and thus, that should not be allowed. See, *e.g.*, Philip Hirschfeld, "Deciphering Tax Allocation Provisions in a Partnership Agreement," *Probate & Property*, (forthcoming).

2 P.L. 97–248, 96 Stat. 324, enacted September 3, 1982.

3 P.L. 114-74, 114th Cong., 1st Sess. (Nov. 2, 2015)(adopting H.R. 1314).

4 Act, §1101.

respective distributive shares of partnership items consistently with the partnership tax return filed on Form 1065. If there is a partnership audit that determines a partnership item to be changed, then that adjustment should be binding on all partners. After partnership-level adjustments are made, the I.R.S. then needs to pursue collection from each partner, which also takes into account each partner's own overall tax situation. For example, a partnership-level adjustment that reports added taxable income to a partner may be offset by tax losses of that partner so that no tax currently due by that partner.

T.E.F.R.A. divided the world of partnership audits into three categories:

1. Small partnerships are exempt from these unified partnership audit rules. Two requirements must be met in order to qualify for this exception:

    a. the partnership must have ten or fewer partners

    b. all partners must be individuals who are U.S. citizens or resident aliens, estates of deceased partners, or C Corporations[5]

    A small partnership may elect to be covered by the T.E.F.R.A. procedures by attaching a statement to the partnership return for the first year in which the election is to be effective.[6]

2. Partnerships with 100 or more partners can elect to become electing large partnerships ("E.L.P.'s").[7] Code §§6240-6255, which is Subchapter D of Chapter 63 of the Code, provides special audit procedures for E.L.P.'s. The E.L.P. audit rules differ from the rules that otherwise apply under T.E.F.R.A. A major distinction is that for an E.L.P., any partnership audit adjustment made for an earlier taxable year does not require each partner to have to adjust its taxable income for that prior year. Rather, the partnership can take that adjustment into account in reporting each partner's share of taxable income for the year in which the adjustment is made.[8] For example, if the 2012 partnership taxable year is under audit and an I.R.S. adjustment is made in 2015 that results in $100 of added taxable income for each partner, the partnership can report that $100 taxable income as added income allocable to each of the partners for 2015; the I.R.S. does not have to chase each partner to make sure they filed an amended 2012 tax return. An E.L.P. can be liable for the unpaid tax if it elects not to include such income in the current year, or under certain other situations.[9]

3. A partnership that is not a small partnership or an E.L.P. is subject to the general T.E.F.R.A. audit rules. These rules allow the partnership to resolve matters with the partnership, but the I.R.S. must then pursue each partner to collect the tax, which can be very burdensome for the I.R.S., especially for large partnerships with many partners. This burden on the I.R.S. has translated into lost tax revenue, and as a result, these new partnership audit rules are intended to serve as a revenue raiser within the Act.

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[5] Code §6231(a)(1)(B)(i).

[6] Treas. Reg. §301.6231(a)(1)-1(b).

[7] Code §775.

[8] Code §6242(a)(1).

[9] Code §6242(a)(2).

SUMMARY OF THE NEW LAW

The Act repeals the T.E.F.R.A. unified partnership audit rules under Subchapter C, as well as the E.L.P. rules under Subchapter D,[10] and replaces them with a new unified partnership audit regime applicable to all partnerships – with some ability to elect out.[11] The existing T.E.F.R.A. rules still apply for all partnership taxable years that begin before January 1, 2018.[12] So, for the time being, the T.E.F.R.A. rules still remain relevant.

"The Act repeals the T.E.F.R.A. unified partnership audit rules under Subchapter C, as well as the E.L.P. rules under Subchapter D, and replaces them with a new unified partnership audit regime applicable to all partnerships – with some ability to elect out."

The new streamlined partnership audit rules create a single set of audit rules for all partnerships. In a major departure from the current law, any adjustments would be taken into account by the partnership (and not each partner). The partnership would pay any tax that is then due at the highest rates of tax in the year the audit is completed or upon expiration of any judicial review.[13]

Partnerships with 100 or fewer partners may elect out of this new law provided that each of the partners is an individual, a C Corporation, any foreign entity that would be a C Corporation were it domestic, an S Corporation, or an estate of a deceased partner.[14] Regulations need to be issued giving further guidance. The reference to individuals is not limited to U.S. citizens or resident alien individuals; in that case, Code §1446 partnership withholding on effectively connected income would still apply. Therefore, the partnership may still be liable for any unpaid tax allocable to any foreign partner.

Partnerships that pay the tax deficiency have the ability to show that the tax liability should be lower if it was based on actual partner-level information from the year under audit rather than imputed amounts determined solely on the partnership's information for such year.[15] I.R.S. guidance on this important option is needed. Such adjustment could be based on amended returns of partners who choose to file, the status of tax exempt partners who may be exempt from tax on such income, or showing a lower tax rate applicable to a partner.[16]

Partnerships have the option to elect out of being personally liable for the added tax if the partnership files an election within 45 days after the date of the final notice of partnership adjustment.[17] The tax burden then shifts to the partners who were partners for the "reviewed year" (*i.e.*, the year under audit). In that case, the partnership will issue adjusted information returns on Form K-1 to those "review year" partners, but the K-1 will be issued for the year in which the "adjustment" is made; the K-1 is then subject to a simplified amended return process rather than a more cumbersome process that would apply if an amended K-1 was issued for the earlier year. While the adjusted K-1 may be for the current year, interest (at higher rates)

10 Act §§1101(a), (b).

11 Act §1101(c).

12 New Code §6241(g).

13 New Code §6221(a), Determination at Partnership Level, and §6225(a)(1), Partnership Adjustment by Secretary.

14 New Act §6221(b). Note that partnerships and trusts are not listed.

15 New Code §6225(c), Modification of Imputed Underpayment.

16 New Code §§6225(c)(2), (3), and (4).

17 New Code §6226, Alternative to Payment of Imputed Underpayment by Partnership.

and penalties are due as if the tax was owed from the prior year.[18] The I.R.S. needs to issue guidance on this election.

The Act also allows a partnership to initiate an adjustment for a reviewed year with the adjustment taken into account in the adjustment year.[19] This election also needs I.R.S. guidance.

BUYER BEWARE: CONCERNS FOR NEW PARTNERS

The new rules will impose tax liability on the partnership. If the current partners are the same as those that were partners in the earlier year under audit, then this procedure should not be harmful to any partner. However, if a person buys a partnership interest from an existing partner or acquires a partnership interest directly from the partnership and there is an audit for a year prior to their admission, then the new rules will expose the new partner to *indirectly* paying partnership tax liabilities that do not truly relate to them (*i.e.*, the partnership bears that expense, therefore reducing the amount of current partnership cash available for distribution to the partners and the value of the partnership interests). New partners need to assess the potential tax exposure for prior years. A new partner may desire to seek indemnification for any past due tax from either the person who sold the partnership interest or from the partnership itself, if the interest was purchased directly.

PARTNERSHIP REPRESENTATIVE REPLACES TAX MATTERS PARTNER

Under current law, a tax matters partner ("T.M.P.") represents partnerships before the I.R.S. in audit proceedings.[20] The Act replaces the T.M.P. with a Partnership Representative ("P.R.").[21] A major difference between the T.M.P. and the P.R. is that a T.M.P. had to be a partner, whereas the partnership can designate as a P.R. who is "a partner (or other person) with a substantial presence in the United States." If the partnership fails to appoint a person as a P.R., then the I.R.S. can appoint "any person" to act as a P.R. I.R.S. guidance is needed to clarify the role of the P.R. Partnership agreements should also be updated to appoint a P.R. and clarify his or her role.

CONCLUSION

The newly enacted partnership audit rules create a major change in tax audits by exposing the partnership to liability for any tax deficiency. Despite the two-year delay in implementation of these new rules, partnerships and partners should begin to analyze the full impact of the new law now and determine whether partnership agreements will need to be amended to reflect these changes. All partnerships and L.L.C.'s should determine whether the new small partnership rules will apply, or if not, whether the partnership or L.L.C. should make the opt-out election mandatory.

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18 New Code §6226(e).

19 New Code §6227, Administrative Adjustment Request by Partnerships.

20 Code §6231(a)(7).

21 New Code §6233(a).

TAX 101:

HOW TO STRUCTURE A CORPORATE DIVISION

Author
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Tags
Corporate Reorganization
Corporate Tax
Spin-off
Split-off
Split-up
Type D Reorganization
Yahoo! Inc.

INTRODUCTION

A corporate division is a transaction that allows (i) a corporation (a "Distributing Corporation") to (ii) separate multiple businesses into separate corporations by (iii) transferring one or more active trades or businesses to an existing or newly-created controlled subsidiary corporation (a "Controlled Corporation") followed by (iv) a distribution of the stock of the Controlled Corporation to its shareholders. A corporate division can also involve the division of an already existing Controlled Corporation that conducts an active trade or business. In Europe, these divisive transactions are often known as "demergers."

In the absence of Internal Revenue Code ("Code") §355, a corporate division would be considered a taxable event for both the Distributing Corporation and its shareholders. The Distributing Corporation would recognize any gain (but not loss) on the distribution of the Controlled Corporation's stock. If a shareholder of the Distributing Corporation receives a *pro rata* distribution of the Controlled Corporation's stock, it will be taxed on the distribution: first as a dividend to the extent of both the Distributing Corporation's and the Controlled Corporation's earnings and profits, then as a recovery of the shareholder's basis, and finally, as capital gain to the extent that the value received exceeds the shareholder's basis.

However, if Code §355 applies, the Distributing Corporation does not recognize gain when it distributes the stock or securities of the Controlled Corporation. In addition, the Distributing Corporation's shareholders and security holders can receive stock or securities of the Controlled Corporation without recognizing gain. Finally, if the Distributing Corporation also distributes other property (known as "boot" in the context of reorganizations) in connection with the exchange, both the Distributing Corporation and its shareholders may recognize gain, but not loss, to the extent of the value of the boot.

FORMS OF CORPORATE DIVISIONS

A tax-free corporate division may take the form of a spin-off, spilt-off, or a spilt-up. It may also be a divisive Type D reorganization.

Spin-off

A spin-off involves the distribution of stock of the Controlled Corporation, on a *pro rata* basis, to the Distributing Corporation's shareholders. After the spin-off, the shareholders of the Distributing Corporation own stock of both the Distributing Corporation and the Controlled Corporation and the Distributing Corporation no longer has control of the stock or assets of the Controlled Corporation.

Example 1:

Corporation A owns and operates grocery stores and an online shopping website. The online shopping website is operated by Corporation B, a wholly-owned subsidiary of Corporation A. Corporation A transfers the stock of Corporation B *pro rata* to its shareholders in a corporate division that meets the requirements of a §355 spin-off.

Spilt-off

A split-off involves the shareholders of the Distributing Corporation exchanging part or all of their Distributing Corporation shares for Controlled Corporation shares. In a split-off, some shareholders of the Distributing Corporation may elect to participate in the split-off and others may not. Thus, after the split-off is completed, one shareholder group may own the Distributing Corporation, while another shareholder group may own the Controlled Corporation. Therefore, split-offs are a way to separate businesses among groups of shareholders. As in a spin-off, the Distributing Corporation no longer controls the Controlled Corporation after the split-off is completed.

Example 2:

Assuming the facts are the same as in the Example 1 above, Corporation A transfers the stock of Corporation B to some or all of its shareholders ("Shareholder Group 1") in exchange for part or all of the shareholders' Corporation B stock. The balance of the shareholders ("Shareholder Group 2") do not participate in the transaction. After the split-off is completed, Corporation A is owned by Shareholder Group 1 and Corporation B is owned by Shareholder Group 2.

Spilt-up

A split-up involves the Distributing Corporation distributing the stock and securities of at least two Controlled Corporations to its shareholders, after which it is liquidated. A split-up may involve either a *pro rata* distribution or a disproportionate distribution of the stock of the Controlled Corporations to the Distributing Corporation's shareholders. When the split-up is completed, the Distributing Corporation no longer exists.

Example 3:

Corporation A operates two businesses: a grocery store business through Corporation B and an online shopping website through Corporation C. Corporation A distributes the Corporation B and Corporation C stock to its shareholders and then is liquidated.

Divisive Type D Reorganization

A transfer of assets to a new or existing Controlled Corporation, followed by a distribution of the Controlled Corporation stock and securities, may qualify as a divisive Type D reorganization, but only if the distribution also meets the requirements of Code §355. The distribution of the Controlled Corporation stock and securities can take the form of a spin-off, split-off, or split-up.

A divisive Type D reorganization must meet the requirements of Code §368(a)(1)(D). Specifically, the Distributing Corporation must transfer assets to one or more corporations; the Distributing Corporation and/or its shareholders must be in control of the corporation immediately after the transfer, and the Distributing Corporation must distribute stock or securities of the corporation pursuant to a plan of reorganization that satisfies the requirements of Code §355.

Thus, a divisive Type D reorganization is a reorganization that meets the requirements of a corporate division under Code §355. But, as demonstrated above, a corporate division can exist in the absence of a divisive Type D reorganization. That is, when there are no asset transfers and the stock distributed is stock of an already existing Controlled Corporation (as in Examples 1, 2, and 3 above).

Example 4:

Corporation A operates both a grocery store business and an online shopping website. It forms a new subsidiary, Corporation B, and transfers the assets and liabilities related to the online shopping website business to Corporation B in exchange for all of its stock pursuant to a plan of reorganization under Code §368(a)(1)(D). Then, Corporation A spins off Corporation B to its shareholders by distributing all of the Corporation B stock *pro rata* pursuant to Code §355.

"A transfer of assets to a new or existing Controlled Corporation, followed by a distribution of the Controlled Corporation stock and securities, may qualify as a divisive Type D reorganization, but only if the distribution also meets the requirements of Code §355."

REQUIREMENTS OF A TAX-FREE CORPORATE DIVISION

A corporate division must meet the following statutory and non-statutory requirements to qualify for tax-free treatment under Code §355.

Control

The Distributing Corporation must control, immediately before the distribution, the subsidiary whose stock or securities are being distributed to shareholders. For this purpose, control means that the Distributing Corporation owns stock representing (i) at least 80% of the total combined voting power of all classes of stock entitled to vote and (ii) at least 80% of the total number of shares of all other classes of stock of the corporation. The latter typically consists of nonvoting preferred shares.

Distribution

Section 355 requires a distribution of the Controlled Corporation's stock by the Distributing Corporation to a shareholder with respect to its stock, or to a security holder in exchange for its securities. The distribution of the Controlled Corporation's stock or securities will be tax-free if the Distributing Corporation distributes all or substantially all (*i.e.*, an amount constituting 80% control, as defined above) of the stock and securities that it owns in the Controlled Corporation. However, boot received by the shareholders or security holders will be taxable.

Active Trade or Business

In order to meet the active trade or business requirement, the Distributing Corporation and the Controlled Corporation must be engaged in an active trade or business immediately after the distribution. Alternatively, this requirement can also be met if immediately before the distribution, the Distributing Corporation has no assets other than stock or securities of two or more Controlled Corporations and each Controlled Corporation is engaged in an active trade or business immediately after the distribution.

The active trades or businesses must have been conducted by the Distributing and/or Controlled Corporations for five years before the distribution and the business(es) must not have been acquired in a taxable transaction during that period.

“In order to meet the active trade or business requirement, the Distributing Corporation and the Controlled Corporation must be engaged in an active trade or business immediately after the distribution.”

This requirement is meant to prevent the avoidance of dividend treatment by disallowing the tax-free division of an existing corporation into an active business entity and an inactive business entity. For example, the division of a corporation into one corporation that owns an operating company and another corporation that only holds stock and securities. An example is Yahoo!, which has its own website operation and owns a significant portion of shares in the e-commerce company Alibaba, but not enough to be in control of Alibaba. A proposed spin-off of Alibaba shares to Yahoo! shareholders appears to have morphed into a spin-off of the historic Yahoo! business while retaining the Alibaba shares. Presumably, the possible tax exposure arising from failing the two active-business requirements is significantly less in the revised plan and might even result in a loss if certain investors are to be believed.

Corporate Business Purpose

A corporate division must be carried out for one or more corporate business purposes in order to receive tax-free treatment under Code §355. This is because tax-free treatment is meant to apply only to distributions that are part of restructurings of corporate operations that are required for business purposes. Further, the business purpose must be the business purpose of the corporation, and not that of the shareholders.

Device Restriction

A §355 corporate division must not be a “device” for the distribution of earnings and profits of the Distributing Corporation or the Controlled Corporation. The purpose of this requirement is to prevent the use of a tax-free distribution under Code §355 as a means for the Distributing Corporation’s shareholders to convert the corporation’s earnings into capital gain. To illustrate, if shareholders sell the stock in the Distributing or Controlled Corporations after the tax-free distribution, the transaction is not significantly different than a sale of the Controlled Corporation by the Distributing Corporation followed by a dividend of the sales proceeds to shareholders. This would be a taxable event for the Distributing Corporation and its shareholders.

An analysis of whether a corporate division is a device for the distribution of earnings is based on all of the facts and circumstances and weighs the presence of device and non-device factors. Factors indicating a device include

- a *pro rata* distribution resembling a dividend,
- a post-distribution sale by the shareholders, and
- the distribution of a disproportionately large amount of assets not used in a trade or business.

Factors considered to be evidence that the division was not a device include

- a strong corporate business purpose,
- a publicly traded Distributing Corporation, and
- the availability of the dividends received deduction to a corporate shareholder.

Continuity of Business Enterprise ("C.O.B.E.")

Under the C.O.B.E. requirement, the Distributing Corporation and the Controlled Corporation must continue their historic businesses or use a significant portion of their historic business assets after the distribution.

Continuity of Interest ("C.O.I.")

The C.O.I. requirement is met if there is continuity of ownership among one or more persons who were the owners of the enterprise before the distribution or exchange. That is, one or more pre-distribution shareholders must own a significant amount of the shares of the Distributing and Controlled Corporations after the distribution. The requirement applies to both the Distributing Corporation and the Controlled Corporation.

Not a Disqualified Investment Corporation

The Distributing Corporation and the Controlled Corporation must not be a "disqualified investment corporation." A corporation is a disqualified investment corporation if, immediately after the distribution, the fair market value of its investment assets is two-thirds or more of the fair market value of its gross assets.

Not a Disqualified Distribution

A corporate-level tax will be imposed on the Distributing Corporation if the distribution is a "disqualified distribution." A distribution is disqualified if, immediately after the distribution, any person holds stock purchased within the five-year period before the distribution (*i.e.*, disqualified stock), which constitutes 50% or more of the interest in the Distributing Corporation or the Controlled Corporation. It also includes a distribution of the Controlled Corporation's stock if the persons who acquired the Distributing Corporation's stock or securities during the five-year period later own a 50% or greater interest in the Controlled Corporation immediately after the distribution.

Distribution Made in Connection with a 50% or Greater Acquisition

A distribution under Code §355 must not be part of a plan to acquire stock of the Distributing or Controlled Corporations. The Distributing Corporation will recognize gain (not loss) as if it had sold the stock of the Controlled Corporation for fair market value, if the distribution is found to be a part of a plan in which one or more persons acquire a 50% or greater interest in the Distributing or Controlled Corporations

CONCLUSION

Tax-free corporate divisions conducted for valid business purposes are allowed under U.S. tax law. However, a corporate division contains similarities to a simple distribution to shareholders of appreciated property where the property takes the form of shares of a subsidiary. Whereas the division is tax-free, the distribution is taxable at two levels – the Distributing Corporation recognizes gain taxed at ordinary income rates and the shareholders report dividend income. The litmus test in distinguishing one tax result from the other is the package of hurdles that must be met in order to obtain tax-free treatment. Guessing wrong as to one of the hurdles can give rise to significant tax exposure. This is the conundrum that is currently faced by Yahoo! regarding its shares in Alibaba.[1]

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1 As of the date of this publication, Yahoo! has indicated that it will spin-off all shares other than those held in Alibaba.

MYLAN'S OPPOSITION TO THE I.R.S. – NO SUBSTANTIAL RIGHTS

Author
Christine Long

Tags
All Substantial Rights
Capital Gains
License
Mylan Inc.
Opposition
Ordinary Income
Patent
Sale

On October 22, 2015, Mylan Inc. ("Mylan") filed its opposition to the I.R.S.'s motion for summary judgment in U.S. Tax Court arguing the transfer of its rights in a blood pressure drug, nebivolol, was a sale that was incorrectly re-characterized as a license by the I.R.S. The salient point of Mylan's opposition is that it sold and did not retain substantial rights in the drug under the 2008 agreement with Forest Laboratories Holdings Limited ("Forest"), and therefore, it properly reported the proceeds as capital gains. Mylan argues the I.R.S.'s summary judgment motion is misguided and must fail because the I.R.S.

- ignores the controlling legal standard by failing to address whether Mylan retained any "substantial rights" following its 2008 agreement with Forest;
- concedes that labels are not determinative, yet seeks to elevate form over substance by relying on labels in the 2008 agreement instead of addressing the reality of what was effectuated through that agreement; and
- focuses on irrelevant facts regarding agreements and administrative proceedings concluded with respect to tax periods that are not before the Tax Court.[1]

BACKGROUND

In the last edition of *Insights*, the article "I.R.S. Argues Mylan's Contract is a License of Drug Rights – Not a Sale"[2] discussed the *Mylan Inc. v. Commissioner* case as addressing the controversy of whether a transfer of exclusive rights to the use of a patent is a sale or a license. As explained in the last article, a sale of patent rights generally occurs for tax purposes when all substantial rights to the property have been relinquished, whereas a license occurs when the company transferring the rights retains a power or significant interest over the property. A sale receives capital gains treatment, which allows the corporation to utilize a capital loss carryback as a means of reducing taxable income. A license generates ordinary income, which cannot be reduced by a capital loss carryback.

At issue is whether Mylan retained any substantial rights in nebivolol after executing its 2008 amendment agreement with Forest. A more elaborate statement of the facts is provided in the previous article, but they may be summarized as follows. Mylan is a generic pharmaceutical company that initially entered into a license contract in 2001 with Janssen Pharmaceutica N.V. ("Janssen"), granting Mylan the exclusive right to use, make, and sell nebivolol and its products within the U.S. and

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1 *Mylan Inc. v. Commr.*, T.C., No. 16145-14, opposition to motion, Oct. 22, 2015, p.1.

2 Christine Long, Andrew Mitchel, and Stanley C. Ruchelman, "I.R.S. Argues Mylan's Contract is a License of Drug Rights – Not a Sale," *Insights* 2, no. 9 (2015).

Canada. Mylan sublicensed its rights in nebivolol to Forest under a 2006 contract in which Forest paid Mylan $75 million and agreed to royalty payments in exchange for the right to develop and commercialize nebivolol in the U.S. and Canada. Under the 2006 agreement, Mylan retained significant rights to nebivolol and reported the payments it received from Forest in 2006 and 2007 as ordinary income. In 2008, the two drug companies executed an amendment to the 2006 contract in which Mylan assigned to Forest all rights to participate in the commercialization of nebivolol. In return for the assignment, Mylan received a one-time cash payment of $370 million and about $50 million of additional royalty payments. However, Mylan retained certain limited rights and obligations in relation to the product and the supplier.

On its 2008 tax return, Mylan characterized the transfer of rights in the nebivolol patent to Forest as an installment sale and reported the payments it received from Forest as capital gains. Under a 2008 amendment, Mylan also reported the payments it received from Forest in 2009 and 2010 as capital gains. Upon examination of its returns, the I.R.S. re-characterized the 2008 contract as a license, not a sale, that generated ordinary income and issued deficiency notices totaling more than $104 million for years 2007 to 2010. Mylan filed two petitions in Tax Court, which have been consolidated into a single proceeding, for a redetermination of the amounts due, asserting that the I.R.S. improperly characterized the 2008 transfer as a license because Mylan had relinquished all substantial rights to nebivolol.[3]

In September, the I.R.S. filed a motion for summary judgment and memorandum in support of its motion arguing the transfer of Mylan's rights in nebivolol to Forest was a license because the 2008 amendment was merely an extension of the 2006 license agreement, not a relinquishment of all substantial rights. The I.R.S. asserted that as a mere amendment to a license that continues to exist, Mylan should report ordinary income. The I.R.S.'s memorandum focuses on labels used in the 2006 and 2008 agreements and contends that no genuine issue of material fact exists and that a decision in its favor should be given by the Tax Court as a matter of law distinguishing between a sale and a license.

MYLAN'S OPPOSITION

Mylan's opposition to the I.R.S.'s summary judgment motion contends that Mylan sold its rights in nebivolol to Forest and properly reported the payments received pursuant to the 2008 agreement as capital gains. Mylan's opposition lays out its arguments as follows:

1. Genuine issues of material fact exist that must be resolved to determine whether the 2008 agreement was a sale or a license.

2. Substance, not labels, controls whether the 2008 agreement resulted in a sale.

3. The all substantial rights doctrine controls whether the transfer of patent interest constitutes a sale or a license for Federal income tax purposes.

4. The parties intended the 2008 agreement to be a sale.[4]

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3 *Mylan Inc. v. Commr.*, T.C., No. 16145-14, petition, Jul. 11, 2014.

4 *Mylan*, opposition to motion, Table of Contents.

Genuine Issues of Material Fact

Mylan's opposition asserts that the I.R.S.'s motion for summary judgment should be dismissed because there are genuine issues of material fact as to whether the 2008 agreement was a sale or license. Mylan argues the I.R.S.'s motion "paints an incomplete picture," only focuses on labels, fails to address the substance of the transaction, and merely denies that the 2008 agreement was effectively a sale without addressing the controlling legal issues of whether Mylan transferred all substantial rights in nebivolol.[5] Mylan points out that the I.R.S. has not satisfied its burden of proof that no material dispute of fact exists and does not present indisputable evidence of a sale or demonstrate that a decision may be rendered as a matter of law. Mylan also asserts that the I.R.S.'s contentions, at the very least, present genuine issues that should be determined at trial.

Substance Controls, Not Labels

In its opposition, Mylan argues that the I.R.S.'s motion solely relies on the label of the 2008 agreement as a "license" and ignores the controlling legal standard of whether Mylan retained any substantial rights. Although the I.R.S. does acknowledge that labels are not conclusive, it still wrongfully focuses on the agreements' labels in spite of the fact that the Third Circuit and other courts have clearly established that labels are not determinative and "in the patent context, are essentially irrelevant."[6] The case law of the Third Circuit is significant because it would be the venue for an appeal to this case.[7]

Mylan cites numerous cases that support its contention that the substance of a transaction is determinative, not the labels or terminology used.[8] Mylan equates its transfer of rights in nebivolol to other cases where the courts held that the transfer of patent rights was a sale. Mylan points out that the pharmaceutical industry does not rely on the terms "license" and "sale" to determine whether a sale occurred and the industry uses the term "exclusive license" to refer to a sale, which the Third Circuit also recognizes.

The I.R.S.'s motion also asserted that the "Danielson Rule" is applicable to Mylan's case as a matter of contract law because the form of Mylan's agreement is as a license it is not designed as a sale. In *Commr. v. Danielson*,[9] the Third Circuit held that a taxpayer may challenge the tax consequences of its own contract only by introducing evidence that would invalidate the contract itself. However, Mylan's opposition argues that the Danielson Rule is irrelevant because Mylan is not trying to change the terms of the agreement, unlike the sellers in Danielson. Mylan is instead arguing that all substantial rights of value were transferred pursuant to the 2008 agreement and, "to the extent the taxpayer is not arguing to change the terms of the applicable agreement, *Danielson* does not apply."[10]

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5 *Id.*, p. 19.

6 *Id.*

7 *Id.*, p. 2.

8 *Id.*, p. 21.

9 *Commr. v. Danielson*, 378 F.2d 771 (3d Cir. 1967).

10 *Mylan*, opposition to motion, p. 29.

Ultimately, Mylan's opposition emphasizes that patent cases support its argument that the labels and terminology of the 2008 agreement do not control whether it was a sale or license for Federal income tax purposes and the I.R.S.'s motion failed to focus on the substance of the agreement being a relinquishment of all substantial rights in nebivolol.

"Mylan's opposition includes a chart of the 'purported 'right[s]'' and the 'status after the 2008 agreement,' indicating that Mylan did not have significant rights in nebivolol after the 2008 agreement."

All Substantial Rights

The main argument of Mylan's opposition is that, in its 2008 agreement with Forest, Mylan transferred all remaining substantial rights that it originally obtained from Janssen in 2001.[11] The I.R.S.'s motion ignores this fact and ignores the standards of the all substantial rights doctrine, which controls whether the transfer of patent interest constitutes a sale or license for Federal income tax purposes.[12] Mylan's opposition states that the express language of the 2008 agreement directly refutes the I.R.S.'s claim that Mylan retained certain rights. The I.R.S. merely lists various "rights" Mylan retained after the 2008 agreement and does not explain why those rights are significant. Mylan's opposition explains that any rights that were retained were "(i) eliminated by the 2008 Agreement, (ii) made irrelevant during the interim period between the two agreements, or (iii) solely to protect Mylan's role as guarantor to Janssen, and thus, did not constitute substantial rights."[13]

In order to demonstrate that Mylan transferred all substantial rights in nebivolol to Forest, Mylan's opposition includes a chart of the "purported 'right[s]'" and the "status after the 2008 agreement," indicating that Mylan did not have significant rights in nebivolol after the 2008 agreement:

- *The Right to "Supply Compound to Forest"*: After the 2008 agreement, this became a "burden, not a right, as Mylan was required to act as a middle man between Janssen and Forest."
- *The Right to "Review Development and Marketing Materials"*: After the 2008 agreement, "Mylan had no right to vote on or assert any control over any of Forest's decisions with respect to nebivolol."
- *The Right to "'Use' of Nebivolol and Mylan Know-How"*: "Mylan's ability to 'use' nebivolol was transferred to Forest in 2008; [after the 2008 agreement] Mylan had no rights to know-how and Mylan developed no know-how in connection with nebivolol [that was] of any value to Mylan."
- *The Right in "Discounting Restrictions on Forest"*: After the 2008 agreement, the "discounting restrictions did not interfere with Forest's full and exclusive use of the patent rights, and only served to protect Mylan's contingent consideration for the three years following the 2008 Agreement."
- *The "Right to Negotiate with Forest to Be Distributor of Authorized Generic*": After the 2008 agreement, "Mylan's first right to distribute an authorized generic was eliminated, and all that remained was that Forest would offer to negotiate with Mylan if Forest chose not to use its own in-house generic division."

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[11] *Id.*, p. 20.

[12] *Id.*, p. 35.

[13] *Id.*, p. 36.

- *The "Right to Approve Sublicenses to Non-affiliates"*: After the 2008 agreement, "Forest could simply assign rather than sublicense any of its rights to nebivolol if Mylan tried to unreasonably block or delay its consent to a 'sublicense.'"

- *The "Right to Exploit the Migraine Indication"*: After the 2008 agreement, the "migraine indication was co-exclusive (*i.e.*, Forest had the same option) and placed dosage restrictions on just Mylan that made it economically worthless to Mylan."

- *The Right to "Commercialization"*: After the 2008 agreement, "Forest had the 'sole authority and responsibility…for all Commercialization activities' [as per] 2008 Agreement § 3.1 (Caron Ex. A)."

- *The Rights to "First Option to Launch Authorized Generic," "Development Decision-making Authority," "Marketing Decision-making Authority," "Primary Contact with FDA and Regulatory Strategy Participation," "Option to Co-promote," "Participation and Approval Re: Publication Plans and Announcements," and "Prosecute and Defend Patent Infringement Suits"*: All have all been eliminated in the 2008 agreement.[14]

The Parties Intended a Sale

Mylan's final argument in its opposition is that the parties intended for the 2008 agreement to be a sale, which is evidenced by the companies' actions. The opposition points out that both Mylan and Forest made the sale public knowledge, as each party issued press releases indicating Mylan sold its rights to Forest and the parties' federal securities filings also demonstrate a sale; and Mylan's intention to sell is further evidenced by the fact that the 2008 agreement included a "large up-front nonrefundable payment and elimination or significant reduction in Mylan's continued involvement with nebivolol."[15]

Furthermore, Mylan's opposition argues that its prior closing agreement with the I.R.S. is irrelevant in determining whether the 2008 agreement constitutes a sale or license. The I.R.S.'s motion contends that Mylan "admitted that the 2006 Contract is a License" and, therefore, the 2008 agreement must be a license as well. However, Mylan argues that the characterization of the 2008 agreement does not depend on the 2006 characterization and that it actually eliminated most of the rights Mylan had in the 2006 agreement.[16] Mylan refers to the Internal Revenue Code and quotes the Commissioner in supporting its argument that closing agreements must have explicitly covered the tax years at issue. Since the closing agreement the I.R.S. refers to in its motion only covers years under the 2006 agreement, it does not apply to the 2008 agreement.[17]

Mylan's opposition concludes by emphasizing that "in the patent context where the governing precedent is clear – labels do not control and the determinative question is whether a party transfers all of the substantial rights it holds in the patent."

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14 *Id.*, p. 53-55.

15 *Id.*, p. 55.

16 *Id.*, p. 59.

17 *Id.*, p. 61.

CONCLUSION

The I.R.S.'s motion for summary judgment will probably be denied. Mylan's opposition thoroughly addresses and counters the I.R.S.'s unsubstantiated arguments, and the I.R.S. has barely addressed whether the rights Mylan retained after the 2008 agreement were substantial. Nonetheless, genuine issues of material fact still remain as to whether the 2008 agreement is a sale or license.

Mylan appears to have met the controlling legal standards of the all substantial rights doctrine and sale versus license determinations in the patent context. Mylan's opposition demonstrates how Mylan transferred all substantial rights in nebivolol to Forest, which should be treated as a sale generating capital gains.

"The I.R.S.'s motion for summary judgment will probably be denied. Mylan's opposition thoroughly addresses and counters the I.R.S.'s unsubstantiated arguments."

ANTI-INVERSION RULES EXPANDED

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Tags
Code §7874
Corporate Tax
Inversions

INTRODUCTION

The latest step in inversion controversy involving U.S. publicly traded corporations is the upcoming merger between pharmaceutical giants, Pfizer and Allergen, in a stock transaction estimated to be worth $160 billion.

The merger is structured as an inversion, in which a U.S. company (Pfizer) combines with a non-U.S. company (Allergen) headquartered in another country. More than 50 similar transactions have been completed over the last three decades, involving companies such as Medtronic, Fruit of the Loom, and Ingersoll Rand. Congressional researchers have estimated that inversions will cost the U.S. treasury $20 billion in the next ten years.

The U.S. Treasury department recently announced that new rules will be issued to limit the attraction of an inversion.

BACKGROUND

The acquisition of a U.S. corporation or its properties is an inversion if three conditions are met.

- The foreign acquiring corporation directly or indirectly acquires substantially all of the properties held directly or indirectly by a domestic corporation;
- After the acquisition, at least 60% of the stock of the foreign acquiring corporation, measured by vote or value, is held by former shareholders of the domestic corporation by reason of having been shareholders of the domestic corporation; and
- After the acquisition, the expanded affiliated group that includes the foreign acquiring corporation ("E.A.G.") does not have substantial business activities in the foreign country in which, or under the law of which, the foreign acquiring corporation is created or organized; this occurs when less than 25% of the business activity of the E.A.G. are in the home country of the foreign acquiring corporation.

If the U.S. shareholders own 80% or more of the new foreign parent, again measured by vote or value, the foreign acquisition corporation is treated as a U.S. corporation. If, instead, the ownership percentage is at least 60% but less than 80%, the foreign acquiring corporation is respected as a foreign corporation, but the domestic entity and certain related U.S. persons based on 50% ownership are treated as expatriated entities. These entities must recognize income or gain realized from the transfer of stock or other properties in the transaction. They also must recognize income from certain transactions and licenses for a period of ten years without the opportunity to reduce tax by credits, expenses paid to related foreign persons, or net operating loss carryovers.

GUIDANCE

The I.R.S. has identified several planning opportunities that it believes is abusive because they prevent application of the anti-inversion rules. In Notice 2015-79, the I.R.S. outlined forthcoming guidance on corporate inversions in response to the identified abuses. The abusive plans and the I.R.S. responses include the following:

- *Manipulating Substantial Activity Rules*: The I.R.S. is aware of transactions in which a taxpayer asserts that the E.A.G. has substantial business activities in the relevant foreign country, but the foreign acquiring corporation is not subject to income taxation in the relevant foreign country as a resident. According to the I.R.S., this is abusive. Accordingly, the Treasury Department and the I.R.S. intends to issue regulations under Code §7874 to provide that an E.A.G. cannot have substantial business activities in a foreign country unless the foreign acquiring corporation is subject to tax as a resident of the that country.

- *Third Country Transactions*: The I.R.S. is aware that certain acquisitions in which a domestic entity combines with an existing foreign corporation are structured by establishing a new foreign parent corporation with a tax residence that is different from that of the existing foreign corporation. In these transactions, the stock or assets of the existing foreign corporation are acquired by the new third-country parent and the U.S. shareholder group own less than 80% of the parent in the third country. The I.R.S. is concerned that a decision to locate the tax residence of a new foreign parent corporation outside of both the United States and the jurisdiction in which the existing foreign corporation is tax resident generally is driven by abusive tax planning. This may include choosing a country with a more favorable tax system or a more favorable treaty with the U.S. This allows a third-country parent to use low-tax or no-tax entities to erode the U.S. tax base following the acquisition. Accordingly, regulations will be issued to disregard certain stock of a foreign acquiring corporation that is issued to the shareholders of the existing foreign corporation for purposes of determining whether the 80% threshold is met.

  The regulations will apply to an acquisition that satisfies four requirements:

  - The foreign acquiring corporation directly or indirectly acquires substantially all of the properties held directly or indirectly by another foreign corporation;
  - The gross value of all property directly or indirectly acquired by the foreign acquiring corporation in the foreign target acquisition exceeds 60% of the gross value of all foreign group property computed by ignoring excluded property;
  - The tax residence of the foreign acquiring corporation is not the same as that of the foreign target corporation, immediately before the transaction; and
  - The ownership percentage maintained by the U.S. shareholder group is at least 60% but less than 80%.

"The U.S. Treasury department recently announced that new rules will be issued to limit the attraction of an inversion."

- *Disregard of Stock Transferred in Exchange for Nonqualified Property*: Stock of the foreign acquiring corporation that is sold in a public offering related to the acquisition is excluded from the denominator of the ownership fraction. Disqualified stock includes stock of the foreign acquiring corporation that is transferred in exchange for "nonqualified property." Nonqualified property includes (i) cash or cash equivalents, (ii) marketable securities, (iii) certain obligations, and (iv) any other property acquired with a principal purpose of avoiding the anti-inversion rules. The I.R.S. is concerned that some taxpayers are narrowly interpreting the definition of avoidance property, contending that it is limited to stock that is used to transfer indirectly specified nonqualified property to the foreign acquiring corporation. Accordingly, the I.R.S. will issue regulations to provide that avoidance property means any property (other than specified nonqualified property) acquired with a principal purpose of avoiding the purposes of Code §7874, regardless of whether the transaction involves an indirect transfer of specified nonqualified property.

- *Post-Acquisition Transactions*: The I.R.S. is concerned that certain indirect transfers of stock or other property by an expatriated entity rather than direct transfers by the expatriated entity itself have the effect of removing foreign operations from U.S. taxing jurisdiction because under current law the income is not inversion gain. Consequently, attributes can be used to reduce the tax. Accordingly, the I.R.S. will issue regulations providing that inversion gains include income or gain recognized by an expatriated entity from an indirect transfer or license of property if the transfer or license is to a specified related person.

- *Code §1248 Toll Charges*: Current §367(b) regulations require a shareholder that exchanges stock in a transaction resulting in a loss of C.F.C. status to include in its income as a deemed dividend the Code §1248 amount when the exchange results in a loss of future exposure under Code §1248. The I.R.S. is concerned that the toll charge is not a sufficient deterrent. Accordingly, the I.R.S. will amend the regulations so that the exchanging shareholder will also recognize all realized gain with respect to the exchanged stock.

Notice 2015-79 also revises certain provisions previously addressed in Notice 2014-52.

Subject to certain exceptions, Notice 2015-79 is generally effective on or after November 19, 2015, but only if the inversion transaction is completed on or after September 22, 2014, the date on which Notice 2014-52 was issued.

CORPORATE MATTERS:
DIRECTORS AND OFFICERS INSURANCE

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Tags
Corporate Law
D&O Insurance
Delaware
Entity Formation

Many of our clients instruct us from outside the United States to establish companies through which an acquisition or some other transaction will be conducted. After completing our "know your client" obligations for a matter involving a new client, the home country advisors instruct us to form the entity and open a bank account. As mentioned in the past, we generally use Delaware as the formation jurisdiction in this type of situation.[1] Delaware law is widely known, the courts are well thought of in event of a dispute among shareholders, and corporate governance rules generally do not contain hidden traps.

Delaware requires at least one director and as part of the formation process a president, secretary, or assistant secretary is usually appointed. Typically, we are amenable to holding one or more offices as a courtesy to the client. The reason is simple. While the client may travel to the U.S. for the closing of the transaction, he or she often does not regularly stay for extended periods of time in the U.S. following the closing; therefore, it is extremely convenient for a trusted advisor to be asked to be a director or officer of the entity effecting the transaction. Depending on the type of transaction, the client (through the newly-formed entity) may have ongoing obligations – whether it be lease renewals on a purchased rental property or various reporting obligations. If the client is unable to sign documents on a timely basis, it is convenient to have a local person who can be instructed by the client to sign when and as instructed.

We have begun to see advisors insist on the purchase of insurance for risk exposure of persons acting as directors or officers, so called "D&O insurance." Although many of the formation documents typically encountered contain standard indemnity language for directors and officers, the entities involved typically grant limited liability to shareholders or members and the assets of the entity itself may not be enough to give the advisor an acceptable level of comfort. While the tasks performed by the advisor on behalf of the client may appear menial, the title the advisor holds is one typically held by senior management, and if there is to be a claim against the entity, the directors and officers are often included in the resulting litigation.

Even if the client is appointed as a director and officer of the entity, insurance may still be a good idea. Often clients, particularly those from outside of the U.S., believe that the limited number of shareholders, directors, and officers and the relatively small size of the business means there is no need for D&O insurance. It is important to remember, however, that a company's directors and officers can be held personally liable for management decisions, and if they are not indemnified by the company, a D&O liability policy will become the sole source for reimbursement.

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1 Nina Krauthamer, Kenneth Lobo, Simon Prisk, and Sheryl Shah, "Corporate Matters: Delaware or New York L.L.C.?," *Insights* 1, no. 8 (2014).

Suits against directors and officers threaten the well-being of the company as well as the personal assets of the directors and officers.

WHAT IS D&O INSURANCE?

D&O insurance is liability insurance that provides personal protection to a company's directors, managers, and officers as individuals. It is designed to protect these persons against allegations of wrongdoing brought in connection with their acting as corporate officers. D&O insurance covers actions taken that have resulted in negative financial consequences for the company. The policy will also provide coverage for defense costs. A D&O policy will not cover claims that are the result of dishonest activity and fraud or personal injury and property damage.

"D&O insurance is liability insurance that provides personal protection to a company's directors, managers, and officers as individuals. It is designed to protect these persons against allegations of wrongdoing brought in connection with their acting as corporate officers."

D&O insurance is similar but not the same as "errors and omissions insurance." Whereas D&O insurance protects against perceived failures in the performance of management duties in connection with general oversight of the internal activities of an organization, Errors and Omissions insurance covers failures in the provision of services, and is generally applicable to those who provide the services directly to clients.

APPLICATION AND COST

To obtain D&O insurance, we work through a broker and help the client with the application process. The application will require the entity to certify compliance with the Patriot Act and all Office of Foreign Assets Control requirements. Care is needed in negotiating terms of coverage and matters like majority shareholder exclusions – where carriers seek to exclude coverage for minority shareholder claimants – should be closely examined.

Our broker described a case where the majority owner of a closely held corporation decided to take the company public and did not disclose his intentions to the minority shareholders. He hired an investment banker and was well along in the process of going public when he bought the minority owners shares for $22,000,000 and subsequently sold the shares in a public offering for $82,000,000. The minority shareholders filed suit. The cases cost $12,000,000 to settle and $5,000,000 to defend. No insurance was available due to the inclusion of a majority shareholder exclusion in the policy.

Underwriters may also want to avoid family conflicts by inserting family exclusions. The appearance of this clause will depend on the composition of the board and the decision to include can vary among insurance carriers depending on their evaluation of the risk profile.

Broad form contractual liability exclusions should also be closely examined. Although errors and omissions coverage is designed for covering third-party professional services, directors and officers are often sued on the basis of failure to supervise.

A bankruptcy exclusion works to eliminate coverage for claims filed by, for example, vendors who have extended credit to an entity and are claiming misrepresentation.

If the claim arises post-bankruptcy, the exclusion will eliminate coverage anticipated by the directors and officers.

While it is hard to give an accurate annual price for coverage – in a situation where the entity is a holding company owning real estate assets, we have found the annual cost of coverage to be in the $3,000 to $5,000 range.

For advisors acting as directors and officers, D&O insurance is also desirable from a client relationship point of view. If there is an instance where a director or officer has a claim, the claim can be made through a third-party insurance company – obviously with client involvement but perhaps without the unpleasantness of making such a claim directly to a client.

F.A.T.C.A. 24/7

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Tags
F.A.T.C.A.
I.G.A.

UPGRADES TO REGISTRATION SYSTEM ALLOW FOR REGISTRATION OF SPONSORED ENTITIES

On November 16, the I.R.S. updated its Foreign Account Tax Compliance Act ("F.A.T.C.A.") Online Registration System. One of the important features of the upgrade is that the I.R.S. now enables sponsoring entities to register their sponsored entities to obtain a global intermediary identification number ("G.I.I.N."). The upgraded system will also allow users to update their information, download registration tables, and change their financial institution type.

F.A.T.C.A. requires certain sponsored entities, including those to which an I.G.A. is applicable, to have their own G.I.I.N. for F.A.T.C.A. reporting and withholding purposes. The regulations allowed sponsored entities to use the sponsoring entity's G.I.I.N. until the date a streamlined procedure for registration of sponsored entities was published by the I.R.S. or, if later, December 31, 2015. In October, the I.R.S. pushed back the latter date to December 31, 2016; however, prior to the November 16 upgrade, sponsoring entities could not register their sponsored entities. This upgrade allows sponsoring entities to add sponsored entities and, if applicable, sponsored subsidiary branches. These entities can be added one-by-one or all at once by submitting a file containing information for multiple entities. In a November 23 press release, Commissioner John Koskinen said that:

> These upgrades improve the F.A.T.C.A. process, enabling the registration of sponsored entities and making it easier for registrants to use. Working with financial institutions and through intergovernmental agreements, our progress against undisclosed foreign accounts continues.

In the press release, the I.R.S. said that, to date, more than 170,000 financial institutions located in more than 200 jurisdictions have registered with the I.R.S.

As part of this upgrade, the I.R.S. issued an updated online registration guide, which, among other changes, is a shorter and easier to understand version of the old guide issued in October 2014. The new guide includes several updates; among other changes, it adds two new registration questions. Question 3B asks for the financial institution's tax identification number in its country or jurisdiction, and the two-part Question 13 requests common parent entity information. In 13A, the financial institution must disclose whether it is the common parent entity of an expanded affiliated group. In 13B, if the financial institution is not the common parent of its group, it must then provide the legal name of the common parent entity, as well as its F.A.T.C.A. identification number, if known.

COMPETENT AUTHORITY AGREEMENTS SIGNED

To facilitate the exchange of information under F.A.T.C.A. and to establish and prescribe the rules and procedures necessary to implement certain provisions in an intergovernmental agreement ("I.G.A."), the competent authorities of the U.S. and an I.G.A. partner should sign a Competent Authority Arrangement ("C.A.A."). The first C.A.A.'s were signed by the U.K. and Australia in late September. The I.R.S. then said it expects that numerous other C.A.A.'s with additional competent authorities in I.G.A. jurisdictions "will be signed in the near future."

That process is now beginning on a more routine basis:

- On October 1, the U.S. released the official text of the C.A.A. signed with Mauritius and the Czech Republic in accordance with the I.G.A. signed between the U.S. and these two countries;
- On October 19, the U.S. released the C.A.A. signed with Estonia;
- On October 20, the C.A.A. signed between the U.S. and South African competent authorities entered into force;
- On October 21, the U.S. released the C.A.A. signed with Mexico;
- On October 26, the U.S. released the C.A.A. signed with Malta;
- On November 9, the Irish and U.S. competent authorities signed a C.A.A.;
- On November 10, the Isle of Man and U.S. competent authorities released the C.A.A., which was signed on October 14 by the U.S. and on September 17 by Isle of Man;
- On November 15, the U.S. released the C.A.A. signed with Latvia; and
- On November 24, the U.S. released the C.A.A. signed with Denmark.

Additional C.A.A.'s were signed with Luxembourg, Liechtenstein, India, Guernsey and New Zealand, among other countries. All C.A.A.'s will become operative on the later of the date the applicable I.G.A. enters into force, or the date the C.A.A. is signed by the U.S. and the partner country.

ADDITIONAL FOREIGN GUIDANCE

On November 16, the Turks and Caicos Islands government issued guidance notes on the compliance requirements of its I.G.A. with the U.S., as well as its tax information exchange agreement with the United Kingdom.

On November 13, Russia's Central Bank released new guidelines to clarify how banking businesses should implement F.A.T.C.A. and the related provisions of the Russian legislation. On June 28, 2014, Russia passed new legislation to implement F.A.T.C.A. Such law allowed Russian financial institutions to share information directly with foreign tax authorities and to withhold applicable foreign taxes. According to the newly released guidance, Russian banks are required to notify the Russian tax authorities about registration with overseas tax authorities and about sending any reports to foreign tax agencies, including "zero" reports reflecting that there are no foreign accounts maintained. Additionally, Russian financial institutions may discontinue rendering financial services to clients who object to their information being reported. Russia still, however, has not signed an I.G.A. with the U.S.

"Russian banks are required to notify the Russian tax authorities about registration with overseas tax authorities and about sending any reports to foreign tax agencies."

On November 11, the *Georgian Official Gazette* published amendments to laws regarding

- activities of commercial banks,
- micro-finance organizations, and
- non-state pension insurance and security.

The amendments clarified disclosure provisions affected by the I.G.A. signed with the U.S. on July 10, 2015. According to such amendments, Georgian commercial banks may refuse to open or close an existing account of a taxpayer who does not provide the required information under the I.G.A.

On November 3, the German Ministry of Finance published, in German, a memorandum on implementing its I.G.A. with the United States.

ANGOLA I.G.A. AVAILABLE

On November 9, Angola and the U.S. signed a non-reciprocal Model 1 I.G.A. The text of the I.G.A. was released on the same day. The I.G.A. was treated as in effect as of November 30, 2014.

PRIVACY & F.A.T.C.A.: TWO WORLDS APART

At the International Conference on Taxpayer Rights held in Washington D.C. on November 19, panelists discussed concerns about the movement for international exchange of tax information that started with F.A.T.C.A. but has been gaining momentum due to the O.E.C.D.'s initiative for the Common Reporting Standard ("C.R.S."), which is set to begin within early enforcer countries on January 1, 2016. While demands for tax transparency have grown quickly in recent years, fundamental rights to personal privacy enshrined in E.U. treaties may hamper the implementation of new information exchange rules, some speakers warned.

"We have moved very far and fast from exchange of information on demand," Philip Baker QC of Field Court Tax Chambers in London said to several hundred tax professionals from 22 countries around the world. "Very little attention has been paid to privacy safeguards."

The E.U.'s Data Protection Working Party has warned repeatedly that F.A.T.C.A., the C.R.S., and other data exchange proposals could subject Europeans to transfers of personal data to countries such as the U.S. that lack strong data protection, Baker said. Notwithstanding the panelists' concerns, implementation of F.A.T.C.A. and the C.R.S. are still proceeding.

UPDATES TO F.A.Q.'S ON FOREIGN FINANCIAL INSTITUTIONS

On November 19, the I.R.S. revised a list of F.A.T.C.A. frequently asked questions ("F.A.Q.'s") on its searchable and downloadable list of foreign financial institutions ("F.F.I.'s") that have registered to be compliant under F.A.T.C.A.. The revisions updated many questions and added more on F.F.I. list fields, downloading, and legal entity names.

One addition was Question 3 under the searchable header, which addresses a question many clients have asked: "Why are there multiple global indemnification numbers ("G.I.I.N.'s") associated with a financial institution or branch (same F.I. name and same country/jurisdiction)?"

The I.R.S. indicated that there are three reasons why this will occur. The first reason is that the entity is both a financial institution ("F.I.") and a sponsoring entity, which requires a separate registration. The second reason is that the entity recently completed a change of F.I. type or a transfer to an expanded affiliated group ("E.A.G."). Lastly, the third reason given was that when an F.I. is in the process of transferring into another E.A.G. or changing its F.I. type, it will appear multiple times on the F.F.I. List depending on the number of changes/transfers.

"Many clients have asked: 'Why are there multiple global indemnification numbers ('G.I.I.N.'s') associated with a financial institution or branch ([with the] same F.I. name and same country/jurisdiction)?'"

CURRENT I.G.A. PARTNER COUNTRIES

To date, the U.S. has signed, or reached an agreement to sign, more than 100 Model 1 I.G.A.'s. An I.G.A. has become a global standard in government efforts to curb tax evasion and avoidance on offshore activities and encourage transparency.

At this time, the countries that are Model 1 partners by execution of an agreement or concluding an agreement in principle are:

Algeria
Angola
Anguilla
Antigua & Barbuda
Australia
Azerbaijan
Bahamas
Bahrain
Barbados
Belarus
Belgium
Brazil
British Virgin Islands
Bulgaria
Cabo Verde
Cambodia
Canada
Cayman Islands
China
Gibraltar
Greece
Greenland
Grenada
Guernsey
Guyana
Haiti
Holy See
Honduras
Hungary
Iceland
India
Indonesia
Ireland
Isle of Man
Israel
Italy
Jamaica
Jersey
New Zealand
Norway
Panama
Peru
Philippines
Poland
Portugal
Qatar
Romania
Saudi Arabia
Serbia
Seychelles
Slovak Republic
Slovenia
South Africa
South Korea
Spain
St. Kitts & Nevis
St. Lucia

Colombia	Kazakhstan	St. Lucia
Costa Rica	Kosovo	St. Vincent & the Grenadines
Croatia	Kuwait	Sweden
Curaçao	Latvia	Thailand
Cyprus	Liechtenstein	Trinidad & Tobago
Czech Republic	Lithuania	Tunisia
Denmark	Luxembourg	Turkey
Dominica	Malaysia	Turkmenistan
Dominican Republic	Malta	Turks & Caicos Islands
Estonia	Mauritius	Ukraine
Finland	Mexico	United Arab Emirates
France	Montenegro	United Kingdom
Georgia	Montserrat	Uzbekistan
Germany	Netherlands	

The countries that are Model 2 partners by execution of an agreement or concluding an agreement in principle are: Armenia, Austria, Bermuda, Chile, Hong Kong, Iraq, Japan, Macao, Moldova, Nicaragua, Paraguay, San Marino, Switzerland, and Taiwan.

This list will continue to grow.

UPDATES & TIDBITS

Author
Sheryl Shah

Tags
Fiat
I.P. Box
Starbucks
State Aid

STARBUCKS & FIAT TO REPAY MAX OF €60 MILLION TO E.U.

Concluding a lengthy, two-year investigation, the E.U. has decided that Starbucks Corp. and a Fiat Chrysler Automobiles NV unit must each pay as much as €30 million in back taxes recoverable from illegal tax deals between the companies and the Netherlands and Luxembourg.

The E.U. competition commissioner found that "tax rulings that artificially reduce a company's tax burden are not in line with EU state aid rules." Therefore, "[t]hey are illegal." The commissioner expressed hope that this ruling will prevent further tax deals from being brokered and ensure compliance with corporate taxing obligations.

Fiat Chrysler Automobiles NV claimed any financial levy would be "immaterial" to the multinational group's reported results and held that these agreements were not state aid, but rather rulings of law obtained for certainty.

This decision could also lead to repayment orders for Apple Inc. and Amazon.com Inc., as governments continue to challenge agreements that constitute illegal state aid.

STUDY EXPOSES DOUBLE-DIPPING IN I.P. BOX BENEFITS

A new study revealed that existing European intellectual property ("I.P.") tax regimes may allow multinational corporations both the benefit of relief for investment expenses and reduced income tax rates. The study found that recent efforts to attract research and development ("R&D") activity have led E.U. countries to establish considerably different statutory "I.P. Box" tax rates, ranging from 0% to 15%. Compared to traditional I.P. tax incentives, these I.P. Boxes target the income produced rather than the cost of development.

The European Parliament Directorate-General for Internal Policies conducted a study on the nature of I.P. assets and their use in tax planning, which found that the nature of I.P. enables it to be shifted from one country to another without incurring significant expense. Multinational companies have taken advantage of this flexibility by structuring assets in ways that yield the lowest or no taxation. Furthermore, the study found that through the use of tax planning, multinational companies could utilize R&D tax incentives in one country and then dispose of the resulting I.P. to a subsidiary in a lower-tax country so as to also benefit from a low tax rate on income from the use of the I.P.

Measures suggested to counteract such abusive tax planning include the use of withholding taxes on royalties, deduction limitations, retroactive price adjustment clauses, and controlled foreign corporation rules as a means of limiting incentives for profit-shifting. Implementation of these measures poses an inherent challenge, as it may result in double or even triple taxation of the income.

The study highlights the fact that corporate tax is not harmonized globally and it is this lack of unity that leads to tax base erosion and abusive tax planning. As a result, individual changes to the international taxation system may not be sufficient to tackle the issue.

"Existing European intellectual property ('I.P.') tax regimes may allow multinational corporations both the benefit of relief for investment expenses and reduced income tax rates."

The findings are in line with the "coordinated approach" suggested by the O.E.C.D. to avoid double taxation. The modified nexus approach under the O.E.C.D.'s B.E.P.S. Action Plan will specify the substantial activity criteria used to make sure the benefits only apply where relevant. In addition, the scope of eligible I.P. will be limited and the I.P. Box benefit will be applied to net income instead of gross income. According to the study, this will ultimately lead to standardization of the E.U. I.P. box regimes.

NOTES FROM ABROAD: GLOBAL VILLAGE ON THE MOVE - INDIA 2015

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Tags
GGi
Global Village on the Move
India

In October, the author had the privilege of representing GGi North America at Global Village on the Move, an annual leadership development program organized by the Iacocca Institute at Lehigh University. This year's program took place in Mumbai and Virar, India and was hosted by VIVA College.

THE GLOBAL VILLAGE PROGRAM

The Iacocca Institute provides innovative learning experiences to students and young professionals through three programs at Lehigh University. The Global Village program is an Iacocca Institute business and industry initiative where participants from all over the world spend five intense weeks forming business partnerships, developing personal skills, and increasing global business and cultural understanding. The Global Village on the Move, or GVotM, is a shorter program held at different locations across the world annually, providing participants a an opportunity to learn about doing business in the host country through hands-on experience.

GGI'S AFFILIATION

Geneva Group International ("GGi") maintains a close relationship with the Iacocca Institute and selects and sponsors young professionals from its member firms to participate each year. The network invites each firm to submit one employee application for assessment. The application consists of questions about the applicant's personality, professional experience, and future goals. After reviewing all of the applications, GGi selects five representatives – one from each regional sector.

This year, the representatives selected came from Bulgaria, Nigeria, India, Mexico, and the U.S.

GVOTM 2015 – INDIA: THE NEXT ECONOMIC POWERHOUSE IN THE GLOBAL MARKET

This year, GVotM was hosted by VIVA College in Virar, which is part of the Shri Vishnu Waman Thakur Charitable Trust. The Trust was established by the renowned Thakur family in 1988 to endow and enhance the remote area of Vasai-Virar by providing educational, medical, and societal facilities to the residents. VIVA College provides first-rate, affordable education at its modern facilities where the program was conducted. The college provided an authentic yet comfortable backdrop for the courses; away from the urban city of Mumbai yet local enough that it was easily accessible.

This year's program theme was 'India as the Next Economic Powerhouse in the Global Market'. With the second highest population in the world and exponential economic growth over the last few years, India has become a hub for foreign direct investment. Offsetting this are the strong cultural and ethnic influences that make India a challenging country for any foreign business to survive and succeed. Those who have managed to do so have taken the time to understand and use the "Indian-ness" of the population and mentality as a strength rather than obstacle.

The ten-day program consisted of lectures, site visits, panel discussions, and project work on six industry sectors: real estate, hospitality, finance, retail, I.T., and entertainment. The speakers included some of the highest ranking professionals in the country, including the C.E.O. of the Bombay Stock Exchange, two Indian Administrative Service Officers, the Finance Minister of the State of Haryana, the Mumbai Bureau Chief at the Financial Times, university academics, key personnel at educational non-profits, and chairmen and directors of some of the largest corporations in the country. The talks discussed the current cultural, political, economic, and regulatory framework of the country and changes that are taking place every day. They provided insight into the challenges and advantages of doing business in India by focusing on their personal experiences in business. The industry site visits to the Bombay Stock Exchange, a slum rehabilitation program, the Shapoorji Pallonji Real Estate Imperial Tower project, Bollywood Balaji Telefilms Studio, the Taj Hotel, Datamatics I.T. company, and the shopping mall Phoenix Mills gave us the opportunity to visualize matters discussed at lectures and to apply the theoretical discussions to real settings.

An eclectic group of 40 participants, we came from vastly diverse backgrounds, both culturally and professionally. We had the opportunity to work with academics, students, entrepreneurs, engineers, lawyers, accountants, and consultants from different countries. Each participant brought a range of experiences and a unique perspective to the table, forcing us to broaden our own thinking. The team project assigned involved collaborating and working in a manner that exemplified our strengths and taught us how to learn from our differences. Our project was a consulting assignment for a crowdfunding platform. Being a relatively new concept, it has still not become popular in the country. We were asked to think of ways to encourage the population to both use the platform to raise funds and contribute to projects, while being faced with the challenge that the only returns were reward and not equity based. This required understanding crowdfunding as a business and coming up with ways in which it could succeed in the Indian market.

CONCLUSION

For the author, GVotM India was at the pinnacle of educational and professional programs attended. India is one of the fastest growing and most rapidly emerging nations in the world. Studying the current business and political environment from the perspective of leading professionals actually involved in the cutting edge transformation was eye opening. As were all the participants, I am grateful to GGi, the Iacocca Institute, and the VIVA Group, who meticulously planned and organized the program and our stay for this incredible experience.

IN THE NEWS

AS SEEN IN...

Two articles by Philip Hirschfield have been featured in the A.B.A.'s *Real Property Trust & Estate eReport*. "Purchasing a Partnership/LLC Interest: Tax Tip #1—Requiring Tax Distributions" and "Purchasing a Partnership/LLC Interest: Tax Tip #2 – Code Section 754 Election" highlight practical points to bear in mind when purchasing an interest in a partnership or L.L.C., including the nuts and bolts of how partners or members pay tax and a key election that should not be missed if the entity holds "appreciated" real estate.

Stanley C. Ruchelman and Kenneth Lobo's "Planning for Canadian Parents with U.S. Children" appears in the November 2015 edition of *Taxes & Wealth Management*. The article provides estate planning strategies for families having a mix of U.S. and Canadian ties.

RECENT AND UPCOMING PRESENTATIONS

On October 6, 2015, Stanley C. Ruchelman and Galia Antebi spoke on "Understanding U.S. Taxation of Foreign Investment in Real Property" as part of the two-day conference Current U.S. Tax Planning for Foreign-Controlled (Inbound) Companies, hosted by Bloomberg BNA in New York. The discussion covered legal and tax aspects of structuring U.S. real estate investments and specifically addressed Code §871(d) net income elections for real property rental income, special considerations for partnerships and withholding taxes, including the preparation of statements to reduce F.I.R.P.T.A. withholding tax, planning to reduce estate tax for individual investors, and U.S. tax aspects of cross-border M&A transactions involving U.S. R.P.I.'s.

In October 2015, Beate Erwin attended the International Bar Association Annual Conference in Vienna, Austria, where she participated on the panel "Tax Structuring for Private Clients." The panel utilized case studies to focus on how tax issues impact structures used by private clients.

On November 2, 2015, Galia Antebi presented "An Update of F.A.T.C.A." at the *2015 Advanced Tax Institute*, sponsored by the Maryland State Bar Association and the Maryland Association of C.P.A.'s, in Baltimore, Maryland. The discussion covered an overview of F.A.T.C.A. legislation, the current status of exchanges of financial information between I.G.A. partner countries, and other hot topics, including new account opening procedures in countries that have signed a Model 1 I.G.A.

Copies of our presentations are available on the firm website at www.ruchelaw.com/publications.

About Us

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

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

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

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

Disclaimer

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