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INSIGHTS

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EDITORS' NOTE

In this month's edition of *Insights*, the following topics are addressed:

- **Canada Adopts Changes to Trust & Estate Taxation Rules.** On January 1, new income tax rules came into effect regarding the Canadian taxation of trusts and estates. Use of graduated tax rates for multiple trust, charitable donation credits for estates, and allocation of gains at death are the targets. Amanda Stacey, Nicole D'Aoust, and Rahul Sharma of Miller Thomson LLP, Toronto explain.

- **Italy Modernizes Tax Treatment of L.B.O. Transactions.** In a Circular Letter issued in March by the *Agenzia delle Entrate*, the Italian tax authority, rules were issued providing for rational tax treatment of costs and gains arising in the context of leveraged buyout transactions. Luca Rossi and Marina Ampolilla of Studio Tributario Associato Facchini Rossi & Soci explain the changes and bring good news to investment bankers and their clients.

- **Related-Party Debt: Proposed Code §385 Regulations Raise Major New Hurdles.** In a follow-up piece on newly proposed anti-inversion regulations, Phillip R. Hirschfeld offers a detailed analysis of new debt equity regulations. Mind-boggling complexity is proposed for rules in an area of the tax law that lay dormant for almost 40 years.

- **On the Blacklist – Is Delaware a Tax Haven?** One of the fallouts of the Panama Papers is a European call for a blacklist of countries that fail to meet the O.E.C.D. C.R.S. standards. The European Parliament and several E.U. Member States contend that if the U.S. should be declared a tax haven and added to the European Commission's new blacklist if it does not implement the C.R.S. and B.E.P.S. Project recommendations. Are these contentions based on fact or on political agenda? Christine Long and Beate Erwin explain a trend that that is inching towards an outright trade war.

- **Inbound §332 Liquidations & Inbound Asset Reorganization.** Rusudan Shervashidze and Andrew P. Mitchel continue their examination of U.S. tax rules applicable to cross-border reorganizations, formations, and liquidations. This month, they review rules applicable to the liquidation of a wholly-owned domestic subsidiary corporation into its foreign parent corporation. Also discussed is the toll charge imposed on asset reorganizations that result in the domestication of a foreign subsidiary.

- **U.S. Tax Residency Certification and Spanish Withholding Tax: Early Application Recommended.** Global taxpayers live in a process driven world. It is not enough to be correct when claiming a benefit, the paperwork must be completed. In a detailed article on proper procedure, Beate Erwin and Christine Long explain that U.S. persons claiming treaty tax benefits with regard to payments from Spanish entities face two hurdles. First, they must meet the treaty qualification tests under the limitation on benefits article. Second, they must obtain a U.S. Tax Residency Certification from the I.R.S. before payment is met.

- **Corporate Matters: Earnouts.** What is an earnout? When is it used? How long a term should be considered when computing an earnout? Simon H. Prisk explores the ins and outs of this useful corporate acquisition tactic that makes a portion of the purchase price contingent on a target company achieving certain milestones.

- **B.E.P.S. Around The World.** Kenneth Lobo and Stanley C. Ruchelman look at recent happenings in the world of B.E.P.S. Items covered include (i) recent decisions of the Canada Revenue Agency regarding tax rulings that will be exchanged automatically with other countries, (ii) I.R.S. consideration of accepting early CbC reports from U.S.-based groups, (iii) multilateral procedures to deal with the expected flood of mutual agreement requests arising from double taxation claims when B.E.P.S.-generated taxation claims begin to appear, and (iv) the emerging need for B.E.P.S. compliance officers in multinational groups.

- **Updates & Tidbits.** In this month's update, Elizabeth V. Zanet and Nina Krauthamer report on (i) attacks on cash pooling arrangements as part of earnings-stripping rules under Code §385, (ii) the latest regulations aimed at increasing financial transparency, including adoption of a customer due diligence ("C.D.D.") final rule, (iii) proposed beneficial ownership legislation, and (iv) new reporting rules for foreign-owned, single member L.L.C.'s that engage in business with the foreign owner; as well as a new wave hiring by the I.R.S. of enforcement officers.

We hope you enjoy this issue.

\- The Editors

CANADA ADOPTS CHANGES TO TRUST & ESTATE TAXATION RULES

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Tags
Canada
Charitable Giving
Estate Planning
Graduated Rate Estates
Spousal Trusts
Tax Credits
Trusts

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INTRODUCTION

On January 1, 2016, new income tax rules came into effect regarding the Canadian taxation of trusts, particularly testamentary trusts, and estates (the “New Rules”). These rules were first proposed in the 2013 Federal Budget under measures intended to address concerns over abusive tax planning. Draft legislation, proposing a series of amendments to Canada’s *Income Tax Act* (the “Act”), was released in early 2014 and revised during the summer of 2014.

Organizations representing the Canadian tax, trust, and estate industries have expressed serious concern with the New Rules. In particular, industry representatives took issue with the amendments to the taxation of spousal and similar trusts and questioned the practicality of the New Rules with regard to the use and application of charitable tax credits by Canadian estates. In spite of these concerns, the New Rules received royal assent at the end of 2014, to take effect at the start of 2016.

Following discussions with industry representatives – which have been ongoing from the time the New Rules received royal assent – Canada’s Department of Finance ultimately addressed the most pressing concerns by proposing further amendments to the Act. These proposed amendments were released on January 15, 2016.

This article provides a general overview of the New Rules and the problems they present with regard to the taxation of spousal and similar trusts and the use of charitable donation tax credits by Canadian estates. The article also discusses the manner in which the Department of Finance has proposed to remedy these problems.

BACKGROUND TO THE NEW RULES

As indicated above, Canada’s 2013 Federal Budget included a surprise for tax and estate practitioners. Previously, Canadian testamentary trusts and estates were subject to taxation at graduated rates similar to the graduated rates for individuals. This contrasted with the single tax rate for *inter vivos* trusts, which was the highest marginal tax rate applicable to individuals in the province of the trust’s residence. In the 2013 Federal Budget, the Canadian government announced that it was considering the elimination of graduated tax rates for testamentary trusts. This announcement was followed by a consultation paper, released on June 3, 2013, that proposed, *inter alia*, the application of the highest marginal tax rate to all trusts created by will and all income earned by estates for tax years ending more than 36 months after the death of the relevant individual.

The Federal government’s primary concern was that testamentary trusts were being used in an abusive manner to avoid the payment of tax. In certain cases, the Federal government noted that multiple testamentary trusts were formed in order to benefit from graduated rates multiple times. Estates were taxed in the same manner as testamentary trusts under the law then in effect, and the Federal government expressed the view that the administration of certain estates was being unduly delayed for tax-motivated reasons.

The Federal government also expressed concern with deferral of tax on transfers of property to spousal or similar trusts, which are commonly used as part of Canadian tax and estate planning. Under prior law, the tax imposed on an inherent gain at the time of the transfer was deferred until the death of the beneficiary spouse. In general, all of the net income of a spousal or similar trust was payable to a surviving spouse during his or her lifetime, and discretionary payments of capital could also be made to the surviving spouse during that period. Spousal and similar trusts have become particularly attractive in circumstances involving multiple marriages or blended families.

To a lesser extent, the Federal government was concerned with inter-provincial tax planning involving opportunities that could be derived from manipulating the domicile of trusts. Prior to the New Rules, planning opportunities existed to access lower provincial tax rates based on the tax residence of a trust's trustee.

GRADUATED RATE ESTATES

Based on the Federal government's view that the time required to administer most Canadian estates is 36 months, the New Rules provide that graduated tax rates will apply only to taxation years ending within the first 36 months after the individual's death. During this period, estates are referred to as "graduated rate estates" ("G.R.E.'s") under the New Rules. After the 36-month period, G.R.E. status terminates and a continuing estate will be taxed only at the highest marginal tax rate applicable to individuals in its province of residence. Any testamentary trusts established under the terms of an individual's will are also taxed at the highest applicable marginal tax rate from the time of inception.

SPOUSAL AND SIMILAR TRUSTS

The New Rules introduce changes to Canadian income tax consequences upon the death of a surviving spouse. The new paragraph 104(13.4)(b) of the Act (which forms part of the New Rules) provides that, upon the death of a surviving spouse who is a beneficiary of a spousal trust, the capital gains arising from the deemed disposition are to be taxed in the surviving spouse's estate and not in the trust. Many industry leaders raised concerns regarding the fairness of this provision. It results in considerable inequity when the beneficiaries of a surviving spouse's estate are different from the residuary beneficiaries of the trust. In blended family situations, the capital gains tax liability triggered by the surviving spouse's death was typically borne by the estate. This diminished the overall property available for distribution to the beneficiaries of the estate. At the same time, the capital property of the trust could be distributed to the residuary beneficiaries of the trust and the recipients would take a cost base equal to fair market value of the property received.

A second major concern with the treatment of spousal and similar trusts under the New Rules is the risk of "stranding" charitable donation tax credits ("C.D.T.C.'s,") in a trust that gifts property to a charity after the death of the surviving spouse.

Because the tax liability associated with the surviving spouse's death will be borne by the estate and not by the trust, the trust may not have sufficient income tax payable to obtain a benefit from the donation tax credit. In the one-year period between the adoption and the effective date of the New Rules, practitioners had time to review estate plans in order to identify those involving spousal trusts that would be adversely affected. Typically, estate plans involving blended family situations and residual beneficiaries that differed from the beneficiaries of the surviving spouse's estate were most at risk.

CHARITABLE DONATION TAX CREDITS

Under the New Rules, an estate that is a G.R.E. for the purposes of the Act is generally permitted to allocate C.D.T.C.'s to any of the following taxation years:

- The taxation year of the estate in which the donation was made
- An earlier taxation year of the estate
- The two taxation years of the individual preceding his or her death

"The Federal government's primary concern was that testamentary trusts were being used in an abusive manner to avoid the payment of tax. In certain cases, the government noted that multiple testamentary trusts were formed in order to benefit from graduated rates multiple times."

In general, publicly listed securities and units of mutual funds are exempt from capital gains tax, which arises on an individual's death, if the property is donated to a charity by the individual's estate following his or her passing. The capital gains tax exemption is only applicable to the taxation year of the individual's death.

Industry representatives raised concerns over the feasibility of completing all charitable gifting within the 36-month G.R.E. period in complex estate situations.

PROPOSED CHANGES TO THE NEW RULES

In response to a submission made by the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada, the Department of Finance indicated in November 2015 that it was seeking to understand the concerns raised in respect of the New Rules. On January 15, 2016, the Canadian Department of Finance released legislative proposals to amend certain portions of the New Rules.

The amendments proposed by the Department Finance are aimed principally at the apparent inequity caused by new paragraph 104(13.4)(b) of the Act. The proposed amendments introduce a new paragraph 104(13.4)(b.1), which limits the application of paragraph 104(13.4)(b) to circumstances involving a surviving spouse who meets the following criteria:

- Immediately prior to his or her death, the surviving spouse was resident in Canada.
- The surviving spouse was a beneficiary of a post-1971 spousal or common law testamentary trust that was created by the will of a taxpayer who died before 2017.

If these conditions are met, the trustee or administrator of the surviving spouse's estate may jointly elect with the trustee of the spousal or common law partner testamentary trust to have paragraph 104(13.4)(b) of the Act apply, with the result that

"In the coming months, individuals with estate plans developed in contemplation of the New Rules should revisit planning done prior to the proposed amendments."

the capital gains arising as a result of the surviving spouse's death will be taxed in the estate and not in the spousal or common law partner trust.

For deaths occurring before 2017, there may be compelling tax reasons to make this election. For example, it may be beneficial to make use of the election if there is a capital gain in a spousal trust and, at the time of the surviving spouse's death, he or she had personal capital losses that otherwise could not be used.

As previously noted, the joint election in proposed paragraph 104(13.4)(b.1) of the Act will only be available for spousal trusts created by the will of a taxpayer who died before 2017. Otherwise, the capital gains tax deemed to be recognized in a spousal or similar trust upon the death of a surviving spouse will continue to be taxed in the trust (at the highest marginal tax rate applicable to the trust) and not in the estate of the surviving spouse, as under prior law.

The Department of Finance's proposed amendments to the New Rules also extend the time during which testamentary trusts may allocate C.D.T.C.'s. While the existing legislation allows for the allocation to be made only within a 36-month period following an individual's death, the proposed changes would extend this period to 60 months. According to a Department of Finance release regarding the proposed amendments, it appears that any C.D.T.C.'s arising from donations made after the estate ceased to be a G.R.E. would be allocable among either (i) the taxation year in which the donation was made or (ii) the last two taxation years of the individual.

CONCLUSION

In general, the Department of Finance's proposed amendments to the New Rules would apply from the 2016 tax year. If implemented in the proposed form, the amendments will be welcomed by many individuals, families, and industry members. As drafted, the proposals provide more flexibility with respect to the taxation of capital gains and the period for claiming C.D.T.C.'s. They also restore a perceived sense of fairness to the taxation of spousal and similar trusts.

In the coming months, individuals with estate plans developed in contemplation of the New Rules should revisit planning done prior to the proposed amendments. Others should evaluate how the Department of Finance's proposed amendments will affect their estates and planned charitable giving.

ITALY MODERNIZES TAX TREATMENT OF L.B.O. TRANSACTIONS

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Tags
Investment Banking Fees
Italy
Leveraged Buyout
Management Buyout
Shareholder Loans

On March 30 2016, the Italian Revenue Agency issued the Circular Letter No. 6/E (the "Circular Letter"), which confirms the characterization of a Leveraged Buyout ("L.B.O.") from a tax perspective and addresses certain tax issues that typically arise from this type of transaction. The Circular Letter was designed to create a favorable environment for foreign investment in Italy and to reverse negative publicity arising from interpretative uncertainty over tax consequences.

In this respect, the Circular Letter provides important clarifications concerning

- the deductibility, for corporate income tax ("C.I.T.") purposes, of interest expense incurred in connection with acquisition loans and shareholder loans;
- the appropriate tax treatment, for C.I.T. and V.A.T. purposes, of transaction costs and other fees charged by private equity firms to a target company ("Target") and/or acquisition company ("Bidco"); and
- the taxation of capital gains realized at exit and the reduction of withholding tax on outbound dividends under an applicable Double Tax Convention ("D.T.C."), E.U. directive, or provision of domestic law.

INTEREST DEDUCTIBILITY

Over the past few years, the deductibility of interest incurred in connection with mergers of L.B.O. acquisitions has been challenged by the Italian tax authorities. The typical argument in these matters may be summarized as follows:

- The interest expense was not linked to borrowings incurred in the course of the business activities of Target.
- The L.B.O. transaction was simply a tax-driven transaction involving the pushdown of debt in order to obtain a tax advantage from the resulting interest expense, thereby reducing Italian tax on Target's cash flows.
- In transactions involving foreign investors mainly, the borrowing was not made for business reasons in Italy. Rather, it was incurred at the direction of the ultimate controlling shareholder. This leads to a contention that the borrowing is a form of service rendered by the acquired company for the benefit of the controlling foreign shareholder. The service must be compensated with an arm's length fee, which happens to be equal to the interest deduction.

Breaking with the past, the Circular Letter clarifies that, as a general principle, deductibility of interest on the acquisition loan should be allowed, subject only to ordinary limitations, which include a cap that is approximately 30% of earnings before interest, taxes, depreciation, and amortization ("E.B.I.T.D.A."). In addition, a more

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reasonable transfer pricing rule is applied by Italian Revenue Agency. On the basis of the Circular Letter, the revised treatment is as follows:

- Interest expense borne by a company set up to accomplish the acquisition (either a special purpose vehicle ("S.P.V.") or an existing Bidco) is recognized as being functionally connected to the purchase of Target. Therefore, the deduction of interest expense on third-party debt should be allowed either in the case that the transaction is concluded with (i) the merger of S.P.V./Bidco and Target or (ii) the creation of a fiscal unity between S.P.V./Bidco and Target.

- L.B.O. transactions are recognized as being grounded on sound economic reasons, as they are aimed at acquiring control over Target and this structure (including the debt push down) is usually requested by third-party lenders. Therefore, the leveraged transaction should not be regarded *per se* as abusive. The transaction should only be viewed as abusive when the operation is intended to obtain an undue tax benefit that is contrary to the spirit and objective of the law. An example would be a re-leveraged transaction without a change of control.

- The contention that S.P.V./Bidco acts for the benefit of its ultimate foreign controlling company has been abandoned. On the contrary, following the O.E.C.D. Transfer Pricing Guidelines, if the foreign parent company raises funds on behalf of the subsidiary that uses those funds to acquire a new company, the parent company would generally be regarded as providing a service to the subsidiary for which remuneration would be requested. This could justify the deduction of a service fee (in addition to interest) at the level of the subsidiary.

"Based on the new guidelines, the Italian Tax Authorities may decide to reconsider earlier tax assessments and pending litigation that are based on legal claims that debt pushdowns are generally abusive."

Based on the new guidelines, the Italian Tax Authorities may decide to reconsider earlier tax assessments and pending litigation that are based on legal claims that debt pushdowns are generally abusive. This reassessment would not include instances in which the transaction was specifically aimed at creating an artificial interest expense deduction, which may be the case with re-leveraged transactions within the same group.

SHAREHOLDER LOANS

The Circular Letter explains that interest expense incurred by S.P.V./Bidco on loans granted by foreign shareholders is subject to transfer pricing rules that apply the arm's length principle. Under exceptional circumstances, shareholder loans may be recharacterized as capital contributions where the facts so indicate. For example, an abusive transaction may be presumed to exist if one or more of the following situations occur:

- The reimbursement of the shareholder loan and the payment of the interest are subordinate to payment of loans/interests to third-party lenders.

- The ratios provided under the financial covenants do not consider the shareholder loan as debt and interest accrual as an expense (as opposed to equity).

- The payment of the interest and principal are subject to the same restrictions imposed on dividends distributions and capital reductions.

- In general terms, the shareholder loan and the accompanying interest expense are characterized by lenders as if they are equity capital and dividends.

If recharacterized, the following consequences arise:

- Interest expense accruals on shareholder loans are not deductible.
- Interest payments made in respect of shareholder loans may be subject to withholding tax as dividends.
- The Allowance for Corporate Equity ("A.C.E.") benefit – *i.e.*, a deduction of a notional return equal to 4.5% of the increase in equity – should increase (but specific anti-abuse rules should be considered in order to quantify the benefit).

The Circular Letter states that, in respect of past situations, administrative penalties should be waived since taxpayers have been misled by the interpretative uncertainty of the relevant law.

CORPORATE TAX TREATMENT OF FEES

The Circular Letter states that advisory fees (such as transaction or monitoring fees) charged by a private equity firm may be deducted by Target as long as an economic benefit is derived from the services received. In comparison, fees for services that are provided for the benefit of the investors but paid for by Target are not deductible by Target. Identifying the benefitting party is a factual exercise and all facts and circumstances surrounding the payment must be examined.

The following factors may indicate that advisory fees are paid for services that do not benefit Target:

- Fees paid by Target offset some or all of the management fees due by the fund.
- The amount of the fees paid to the private equity firm or advisory firm exceeds an arm's length amount that is customary for the types of services rendered.
- Payment of the fees is tied to the same limitations provided for dividend distributions to the private equity firm.
- Where the portfolio company is acquired by a consortium of private equity funds, fees charged by the various advisory firms are in proportion to the shareholdings of each private equity firm.

V.A.T. TREATMENT OF FEES

The Circular Letter states that, if S.P.V./Bidco is a passive investor that does not participate in the management of Target, input V.A.T. on various transaction costs may not be recovered by the S.P.V./Bidco used to effect the transaction or a successor company created through a merger with Target ("Mergerco"). In addition, Target is not entitled to recover V.A.T. on services provided for the benefit of the investor group.

EXIT TAX TREATMENT OF CAPITAL GAINS AND DIVIDENDS

Capital gains realized by a foreign S.P.V. that directly holds the shareholdings in the Italian Mergerco or Bidco are taxed at exit as follows:

- Under domestic rules, capital gains realized by non-Italian resident entities are taxable at an effective tax rate of approximately 14%.
- Capital gains realized by white-listed resident entities upon the disposal of a non-substantial shareholding (capped at 20% of voting rights or 25% of share capital) of an unlisted company are exempt from tax.
- Capital gains realized by foreign entities upon the disposal of a non-substantial shareholding (capped at 2% of voting rights or 5% of share capital) of a listed company are exempt from tax.
- Pursuant to Article 13 of a D.T.C. based on the O.E.C.D. Model Tax Convention, capital gains derived from the sale of shareholdings are taxable only in the state of residence of the shareholder.

EXIT TAX TREATMENT OF DIVIDENDS

Dividend distributions from an intermediary Italian holding company that owns shares of Target are taxed at exist as follows:

- Dividends are subject to ordinary withholding tax (currently 26%), which may be reduced pursuant to an applicable D.T.C.
- Dividends distributed to an E.U. parent company may benefit from full exemption from Italian withholding tax under the E.U. Parent-Subsidiary Directive (the "P.S.D."), as implemented in Italy.
- If outbound dividends do not qualify for full exemption under the P.S.D., the E.U. parent company may, in principle, claim the benefit of a reduced withholding tax rate of 1.375%.[1]

"The limitation on benefits deals only with investments made by funds established in blacklisted countries through an E.U. holding company."

LIMITATION ON EXIT TAX BENEFITS

According to the Circular Letter, where the fund is established in a country that does not allow for adequate exchange of information, the intermediary E.U. holding company will not be entitled to tax relief when it does not have sufficient economic substance. In the absence of substance, the intermediary holding company is viewed as having been artificially created to take undue advantage of the benefit provided for in the P.S.D. and/or D.T.C.'s as well as domestic rules that reduce the tax burden on exit.

In the absence of economic substance, an intermediary entity is deemed to have been artificially set up as mere a conduit to its beneficial owner. A non-Italian entity may be viewed as lacking economic substance where the following conditions are met:

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[1] D.P.R. 600/1973, art. 27, para. 3-ter.

- It has a light organization. For example, it does not have full-time employees on its staff and does not have offices and equipment other than those made available by third-party companies through management service agreements. It does not carry out real economic activity, or it has little or no discretion in the decision-making process of its business.

- It does not carry out real economic activity, or it has little or no discretion in the decision-making process of its business.

- It acts as a mere financial conduit in the context of a specific arrangement involving receipts and disbursements that are symmetrical in terms of amount and timing and are not subject to further withholding tax in the state of residence.

If the fund is established in a blacklisted country and the intermediary holding company would be disregarded based on the above arguments, capital gains realized upon the disposal of Target's shares would be subject to tax in Italy and outbound dividends from Italy would be subject to ordinary withholding tax, as if the fund invested directly. Nonetheless, when the fund is set up as a transparent entity, treaty benefits may be claimed directly by the ultimate parent fund's investors under certain circumstances.

WHITE LIST

The above-mentioned limitation deals only with investments made by funds established in blacklisted countries through an E.U. holding company. It should not apply when the fund is located in a country allowing for an adequate exchange of information (a so-called whitelist country) that is also in compliance with E.U. principles.

Countries allowing for adequate exchange of information are currently listed in Ministerial Decree 4 September 1996. This legislation was issued pursuant to Legislative Decree No. 239/1996, which sets the rules for taxation of interest on bonds and similar notes from Italian issuers. Legislative Decree No. 147/2015 introduced recent changes and stated that the white list should be rewritten and updated by ministerial decree every six months, so as to include all the (new) countries that meet the requirements in the intervening time and are therefore considered whitelisted.

In 2015, a number of Tax Information Exchange Agreements ("T.I.E.A.'s") were ratified by the Italian government, including an agreement with the Cayman Islands, Guernsey, and Jersey. Following these developments, and considering the level of actual cooperation attained with regard to exchange of information, there is no longer justification for countries having T.I.E.A.'s with Italy to be excluded from the white list. Therefore, even before a new list is formally issued, it is reasonable to treat these countries as whitelisted.

RELATED-PARTY DEBT: PROPOSED CODE §385 REGULATIONS RAISE MAJOR NEW HURDLES

Author
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Tags
Code §163(j)
Code §385
Code §482
Code §7874
Earnings Stripping
Interest Deductions
Inversions
Related-Party Debt

INTRODUCTION

On April 4, the Treasury Department issued proposed regulations under Code §385[1] that will have a major impact on *any* tax planning involving related-party debt by potentially recharacterizing such debt as equity under three new rules.[2]

- First, a debt recharacterization rule provides that debt instruments are treated as stock if issued in certain disfavored transactions (such as when debt is distributed as a dividend to a shareholder).[3]
- Second, documentation requirements are imposed as a condition to retain the treatment of related-party debt as true debt (and not equity) for tax purposes.[4]
- Third, a bifurcation rule allows the I.R.S. to recharacterize certain related-party debt as part debt and part equity.[5]

While these proposals were accompanied by adoption of new inversion rules under Code §7874,[6] these new Code §385 rules are not limited to debt issued in an inversion. Rather, the Code §385 regulations apply to *any* debt issued between related parties, whether in an international or purely domestic context.

These sweeping changes demand a review of proposed debt arrangements to determine the modifications that are needed to minimize possible adverse impact and alternative action that may be needed if current planning comes within the crosshairs of the new rules.

If finalized, the new debt recharacterization rule would generally apply to any debt instrument issued on or after April 4, 2016.[7] By contrast, the new documentation rules and the bifurcation rule will generally apply to debt issued on or after publication of final regulations under Code §385.[8]

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1 References to a section are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise indicated.

2 Prop. Treas. Reg. §§1.385-1, 2, 3, & 4.

3 Prop. Treas. Reg. §1,385-3.

4 Prop. Treas. Reg. §1,385-2.

5 Prop. Treas. Reg. §1.385-1(d).

6 T.D. 9761 (April 4, 2016). See also Philip Hirschfeld, "Inversions Under Siege: New Treasury Regulations Issued," *Insights* 3, no. 4 (2016).

7 Prop. Treas. Reg. §1.385-3(h).

8 Prop. Treas. Reg. §§1.385-1(f), 2(f).

At the May 2016 meeting of the American Bar Association's Section of Taxation (the "A.B.A. Meeting"),[9] the International Tax Counsel for the Department of the Treasury, Danielle Rolfes, indicated that these proposed regulations are a high priority item for the government. While she indicated that the Treasury is open to some modifications based on comments it receives, the primary goal is to finalize the regulations, especially the debt recharacterization rule, later this year. Rushing to finalize controversial regulations during the last months of an Administration's second term in office is not a new event, and can sometimes lead to less than optimum results.

BACKGROUND

In an attempt to thwart inversions, the Treasury previously issued Notice 2014-52[10] on September 22, 2014 and Notice 2015-79[11] on November 19, 2015. These notices indicated that the Treasury would issue regulations to limit the benefits of certain post-inversion tax avoidance transactions. Among other things, the notices also indicated that the Treasury considered guidance to restrict strategies that avoid U.S. tax on U.S. operations by shifting or "stripping" U.S.-source earnings to lower-tax jurisdictions through the use of intercompany debt. Such transactions are commonly done after an inversion transaction. Although these earlier notices focused solely on inversions, the actions taken on April 4 were not limited to debt issued in an inversion. Affected debt may include debt owed by any U.S. subsidiary to its foreign parent or debt issued by any U.S. corporation, including a real estate investment trust ("R.E.I.T."), to a related U.S. person.

The Treasury's decision to use Code §385 as the means to attack earnings stripping was a surprise. While Code §385 directly addresses debt-equity classification issues, this section was dormant for almost 40 years with no regulations having been issued, apart from a set of regulations that were withdrawn in 1983.[12] At the A.B.A. meeting, some practitioners expressed concern that the Treasury may have acted beyond its powers in adopting the debt recharacterization rule. The International Tax Counsel responded that the Treasury had broad regulatory power under Code §385 that justified its actions. In response to other questions, the International Tax Counsel stated unequivocally that the regulations do not violate the non-discrimination provisions of U.S. tax treaties or otherwise conflict with any treaty.

Code §385(a), as originally enacted,[13] authorizes the Treasury to issue regulations that are necessary to determine whether an interest in a corporation is treated as stock or indebtedness for purposes of the Code. Code §385(b) provides that the regulations shall set forth factors that are to be taken into account in making such determination. These factors may include (i) whether there is a written unconditional promise to pay on demand or on a specified date a sum certain in money in return for an adequate consideration in money or money's worth, and to pay a fixed rate of

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9 References to the A.B.A. Meeting refer to the "Current Developments Panel" at the Foreign Activities of U.S. Taxpayers, Transfer Pricing and U.S. Activities of Foreigners & Tax Treaties Luncheon held on May 6, 2016, at which the author was present.

10 2014-42 IRB 712.

11 2015-49 IRB 775.

12 T.D. 7920, 1983-2 C.B. 69.

13 Tax Reform Act of 1969 (Pub. L. No. 91-172, 83 Stat. 487).

interest; (ii) whether there is subordination to or preference over any indebtedness of the corporation; (iii) the ratio of debt to equity in the corporation; (iv) whether there is convertibility into the stock of the corporation; and (v) the relationship between holdings of stock in the corporation and holdings of the interest in question.

In 1989, Congress amended Code §385(a) to expressly authorize the Treasury to issue regulations under which an interest in a corporation is to be treated as in part stock and in part indebtedness.[14] In 1992, Congress added Code §385(c),[15] which provides that the issuer's characterization (as of the time of issuance) as to whether an interest in a corporation is stock or indebtedness is binding on the issuer and on all holders of such interest (but shall not be binding on the I.R.S.).[16]

TAX BENEFITS OF DEBT

When an investor is asked to infuse capital into a company, it often is valuable for part of that capital to be treated as a loan, rather than an equity investment.[17] As described below, capitalizing a company with debt as well as equity can produce major tax benefits for all parties involved.

Consider a situation where a U.S. subsidiary of a foreign parent company needs more money from its parent company. If the money is advanced for added stock or as a capital contribution, repayment of the amount contributed typically will be made by cash distributions to the shareholder that are subject to the characterization rules of Code §301. These distributions are treated first as dividends to the extent of the company's current or accumulated earnings and profits ("E&P").[18] Dividends distributed to a foreign shareholder are subject to a 30% U.S. withholding tax,[19] which may be reduced or eliminated by an applicable tax treaty.[20] Redemptions may be subject to comparable treatment if the redemption is not treated as a sale or exchange.[21] The company is not allowed a deduction for dividends paid, which results in double taxation of corporate profits.

By contrast, if the shareholder lends the money to the company, three major tax benefits may be derived:

- First, in comparison to a payment of a dividend or a redemption of stock that is treated as a dividend, repayment of the loan principal to a foreign lender is not subject to a 30% U.S. withholding tax.[22] If the lender is a U.S. person, principal payments are not considered to be taxable income.

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14 Omnibus Budget Reconciliation Act of 1989 (Pub. L. No. 101-239, 103 Stat. 2106).

15 Energy Policy Act of 1992 (Pub. L. No. 102-486, 106 Stat. 2776).

16 Code §385(c)(1).

17 Apart from tax concerns, if the company should face financial difficulty, it is sometimes easier to repay a loan to a shareholder rather than a dividend.

18 Code §301(c)(1).

19 Code §§871(a)(1), 881(a)(1), 1441(a), 1442(a).

20 Code §894.

21 Code §302.

22 See *Philadelphia Nat. Bank v. Rothensies*, 43 F. Supp. 923 (E.D. Penn. 1942).

- Second, while interest payments are subject to a 30% U.S. withholding tax that is subject to reduction or elimination by the terms of an applicable income tax treaty, interest payments are generally treated more favorably than dividend payments to portfolio investors. Treaties usually exempt interest from the 30% tax, whereas dividends are taxed at a reduced withholding rate – usually 5% when the dividend is paid to a foreign corporation that owns 10% or more of the stock of the U.S. company, but exempt under specified conditions in recent treaties.[23]

  There is also a portfolio interest exemption under U.S. domestic law. It eliminates U.S. withholding tax on certain payments of interest.[24] The exemption does not apply, *inter alia*, to debt paid to a related person. However, a shareholder of a corporation is only related if he or she owns 10% or more of the voting stock of the company.[25] Ownership includes direct ownership and ownership by attribution.[26] A shareholder may own most of the equity of a corporation and still not be related, if he or she owns only non-voting stock.

"When an investor is asked to infuse capital into a company, it often is valuable for part of that capital to be treated as a loan. . . . Capitalizing a company with debt as well as equity can produce major tax benefits for all parties involved."

- Third, a corporation can claim an interest expense deduction to reduce or eliminate its taxable income.[27] This can serve to eliminate double taxation on corporate profits that occurs when a U.S. corporation is used to conduct business.

  As discussed in the next two sections of this article, there are two primary ways this interest deduction may not be allowed:

  - First, interest deductions may be deferred under the earnings stripping rules of Code §163(j).
  - Second, the I.R.S. may assert that the purported debt instrument should be recharacterized as equity under common law tax principles.

  However, the I.R.S. may be hesitant to challenge the classification under the common law, as it is highly subjective and therefore difficult to prove in most cases. Nonetheless, to avoid a common law challenge, practitioners will often limit lending to maintain a reasonable debt-to-equity ratio for the company.

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23 *E.g.*, under Article 10(2)(a) of the U.S.-German Income Tax Treaty, a 5% withholding rate applies to dividends paid by a U.S. company to a German company that owns at least 10% of the voting stock of the U.S. company – assuming the German company is a German tax resident that satisfies the limitation on benefits ("L.O.B.") provision of the treaty. Alternatively, if the German company owns 80% or more of the voting power of a U.S. company and certain conditions of the L.O.B. provision of the treaty are met, the withholding tax is eliminated. If neither of these conditions is met, a 15% withholding rate applies, under Article 10(2)(b), to dividends paid to a German resident that meets the L.O.B. requirements. Article 11(1) of the treaty eliminates the withholding tax on interest paid by a U.S. company to a German tax resident (assuming the L.O.B. requirements are met).

24 Code §§871(h), 881(c).

25 Code §§871(h)(3), 881(c)(3).

26 Code §871(h)(3)(C), 881(c)(3)(B).

27 Code §163.

EXISTING EARNING STRIPPING LIMITATIONS

"Earnings stripping" is a practice of reducing the taxable income of a corporation by paying interest to related third parties. Code §163(a) allows a deduction for all interest paid or accrued within the tax year on indebtedness. Code §163(j), enacted in 1989,[28] placed substantial restrictions on the amount of certain related-party interest expense deductions that a foreign-owned U.S. corporation may claim when computing its income tax.

The earnings stripping rules under Code §163(j)(2)(A)(ii) generally apply to a U.S. corporation that has a debt-to-equity ratio in excess of 1.5:1 and pays[29] interest to a related foreign person that is not subject to the full 30% U.S. withholding tax.[30] A related person[31] includes a foreign person who owns more than 50% of the value of the stock of the U.S. corporation.[32] If applicable, this provision denies a *current* deduction for the related-party interest expense equal to the *lesser of* (i) the related-party interest expense or (ii) the total interest expense of the corporation that exceeds 50% of the company's adjusted taxable income for the year (the "50% income limitation").[33] The 50% income limitation applies to the corporation's adjusted taxable income, which is the corporation's regular taxable income subject to certain modifications.[34] For example, depreciation deductions are not included in adjusted taxable income, which increases this amount and therefore limits the impact of this rule.[35] Adjusted taxable income is similar in function to the accounting concept of E.B.I.T.D.A. (earnings before interest, tax, depreciation, and amortization).

"Earnings stripping is a practice of reducing the taxable income of a corporation by paying interest to related third parties."

The disallowed interest is *deferred* until the following year[36] when it is then treated as an interest deduction subject to application of the earning stripping rules in that next year. In practice, deductions affected by these rules may be deferred for several years, but they are often allowed in a later year when the U.S. company has significant income (such as from a sale of its assets). This may eventually ameliorate the harsh treatment of the 50% income limitation by allowing the deduction.

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28 Enacted by the Revenue Reconciliation Act of 1989, these rules were a response to the perceived erosion of the U.S. tax base through excessive interest expense deductions.

29 Comparable treatment is provided for interest paid to an unrelated person that is not subject to full 30% withholding tax when a related person provides a credit enhancer that supports the loan. This disallowance applies to interest paid to both foreign creditors that benefit from an income tax treaty and domestic creditors that are subject to full U.S. domestic tax, but not to 30% withholding tax.

30 If the 30% withholding tax is reduced, but not eliminated, then these limitations only apply to a portion of the interest based on the amount of interest that is not subject to withholding tax.

31 Code §163(j)(4).

32 Code §§267(b)(2), (3), (f).

33 Code §§163(j)(1)(A), (2)(B).

34 Code §163(j)(6)(A).

35 Code §163(j)(6)(A)(i)(IV).

36 Code §163(j)(1)(B).

COMMON LAW ON RECHARACTERIZING DEBT AS EQUITY[37]

Recharacterization of a debt as equity involves a determination of whether a debt actually exists for tax purposes. This determination is decided on the basis of the facts presented.[38]

The exposure to recharacterization can be minimized by structuring the cash infusion in accordance with certain basic criteria reviewed by the courts.[39] Courts review these factors on a case-by-case basis and no single factor is dispositive. In making this determination, the courts have mentioned the following important factors that should be considered:

- Presence or absence of a written instrument evidencing the loan
- Names given to the certificates evidencing the indebtedness
- Presence or absence of a fixed maturity date
- Source of the payments
- Right to enforce payments
- Participation in management as a result of the advances
- Status of the advances in relation to regular corporate creditors
- Intent of the parties
- Identity of interest between creditor and stockholder
- "Thinness" of capital structure in relation to debt
- Ability of the corporation to obtain credit from outside sources
- Use to which the advances were put
- Failure of the debtor to repay
- Risk involved in making advances
- Provision of a fixed rate of interest
- Whether or not the indebtedness was secured.

A key factor indicative of a loan is the issuance of a bond, debenture, or note or the existence of a lien. The presence of a fixed maturity date, fixed interest rate, and

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37 For detailed examinations of the common law factors that distinguish debt from equity, see Galia Antebi and Nina Krauthamer, "Debt vs. Equity: Comparing HP Appeal Arguments to the Pepsico Case," *Insights* 3, (2015) pp.9-16, and Galia Antebi and Nina Krauthamer, "Tax 101: Financing a U.S. Subsidiary – Debt vs. Equity." *Insights* 3, (2014) pp. 27-32.

38 *E.g.*, *Berkowitz v. United States*, 411 F.2d 818 (5th Cir. 1969).

39 *Dixie Dairies Corp. v. Commissioner*, 74 T.C. 476, 493 (1980), acq., 1982-2 C.B. 1; *Estate of Mixon v. U.S.*, 464 F2d 394 (5th Cir. 1972).

fixed schedule for payments are also characteristic of a debt obligation, as opposed to equity. Additionally, repayment of the obligation should not be dependent upon the success of the business and the existence of corporate earnings, but rather, it should be made from cash flow.

The ratio of debt to equity, sometimes referred to as the "thin capitalization" issue, is an important factor.[40] Inadequate capitalization of the company is strong evidence of equity status and supports recharacterization of the debt as equity. The determination of undercapitalization is highly factual and may vary substantially by industry and company.

NEW DEBT RECHARACTERIZATION RULE

Background

The Treasury identified three types of transactions between related persons that raised significant policy concerns, which needed to be addressed in the Code §385 regulations. The three transactions are:

- distributions of debt instruments by corporations to their related corporate shareholders;
- issuances of debt instruments by corporations in exchange for stock of an affiliate (including "hook stock" issued by related corporate shareholders); and
- certain issuances of debt instruments as consideration in an exchange pursuant to an internal asset reorganization.[41]

In *Kraft Foods Co. v. Commissioner*,[42] the Second Circuit held that a debt instrument distributed by a U.S. corporation to its shareholder as a dividend was true debt for tax purposes. By contrast, in *Talbot Mills v. Commissioner*,[43] the First Circuit held that notes distributed to a shareholder in exchange for stock should be treated as equity for tax purposes. The Treasury noted that:

> In many contexts, a distribution of a debt instrument similar to the one at issue in *Kraft*, lacks meaningful non-tax significance, such that respecting the distributed instrument as indebtedness for federal tax purposes produces inappropriate results. For example, inverted groups and other foreign-parented groups use these types of transactions to create interest deductions that reduce U.S. source income without investing any new capital in the U.S. operations. In light of these policy concerns, the proposed regulations treat such a debt instrument as equity issued in fact patterns similar to that in *Kraft* as stock.[44]

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[40] *Schnitzer v. Commissioner*, 13 T.C. 43 (1949), aff'd, 183 F.2d 70 (9th Cir. 1950), cert. denied, 340 U.S. 911 (1951).

[41] REG 108060-15, Background, VI(C)(1) (April 4, 2016).

[42] 232 F.2d 118 (2nd Cir. 1956).

[43] 146 F.2d 809 (1st Cir. 1944), aff'd sub nom, *John Kelley Co. v. Commissioner*, 326 U.S. 521 (1946).

[44] *Id.*

Code §304 prevents taxpayers from acquiring affiliate stock to convert what otherwise would be a taxable dividend into a sale or exchange transaction. In a similar manner, the Treasury determined that "the issuance of a related-party debt instrument to acquire stock of a related person is similar in many respects to a distribution of a debt instrument and implicates similar policy considerations."[45]

The proposed regulations also address certain debt instruments issued by an acquiring corporation as consideration in an exchange pursuant to an internal asset reorganization.

> Internal asset reorganizations can operate in a similar manner to Code §304 transactions as a device to convert what otherwise would be a taxable dividend into a sale or exchange transaction without having any meaningful non-tax effect.[46]

Apart from the "general rule" to address these three types of transactions, the Treasury noted that:

> Similar policy concerns arise when a related-party debt instrument is issued in a separate transaction to fund (1) a distribution of cash or other property to a related corporate shareholder; (2) an acquisition of affiliate stock from an affiliate; or (3) certain acquisitions of property from an affiliate pursuant to an internal asset reorganization.

As a result, the regulations adopt an added test, called the "funding rule," to address these attempts to circumvent their new general rule.[47]

Debt Subject to New Rules

To address these concerns, Prop. Treas. Reg. §1.385-3 contains the new debt recharacterization rule. This rule applies to debt issued between members of an expanded group ("E.G."). An E.G. is an affiliated group of corporations within the meaning of Code §1504 (which generally requires 80% ownership) with some significant modifications.[48]

An E.G. expands the statutory definition of affiliated group – which is limited generally to domestic corporations -- by including foreign and tax-exempt corporations. For example, an E.G. will exist if a foreign corporation owns 80% or more of a U.S. corporation.[49] While the Code §1504 definition refers to ownership of 80% or more of stock having both value *and* vote, the E.G. definition covers ownership of 80% or more of either vote *or* value.[50] Also, the proposed regulations adopt the constructive ownership rules of Code §304(c)(3).[51] However, debt between members of a U.S.

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45 REG 108060-15, Background, VI(C)(3) (April 4, 2016).

46 REG 108060-15, Background, VI(C)(4) (April 4, 2016).

47 REG 108060-15, Background, VI(C)(1) (April 4, 2016).

48 Prop. Treas. Reg. §1.385-3(f)(6), §1.385-1(b)(3). An affiliated group of corporations generally files a consolidated federal income tax return.

49 Prop. Treas. Reg. §1.385-1(b)(3)(i)(A).

50 Prop. Treas. Reg. §1.385-1(b)(3)(i)(C).

51 Prop. Treas. Reg. §1.385-1(b)(3)(ii).

consolidated corporate group is not subject to these rules since all the members of that group are treated as one corporation.[52]

General Rule for Debt Recharacterization

Under the general rule, debt between members of an E.G. is subject to reclassification as equity if it is issued in any of the following three situations ("Targeted Transactions"):

- A *distribution* by an E.G. member to a shareholder who is part of that E.G. (*e.g.*, a dividend or return of capital distribution in the form of notes)
- A *transfer* in exchange for *stock* of another E.G. member (*e.g.*, a member of an E.G. acquires stock of another member in exchange for issuing a note to the selling member), other than in an "exempt exchange"
- A *transfer* in exchange for *property* of another E.G. member in the context of certain tax-free asset reorganizations, *but* only to the extent that, pursuant to a plan, a shareholder that is a member of the E.G. before the reorganization receives the debt instrument[53]

For purposes of the second Targeted Transaction listed above, an exempt exchange is an acquisition of E.G. stock where the transferor and transferee of the stock are parties to a reorganization that is an asset reorganization and one of the following conditions is met. Either (i) Code §§361(a) or (b) applies to the transferor of the E.G. stock and the stock is not transferred by issuance, or (ii) Code §1032 or Treas. Reg. §1.1032-2 applies to the transferor of the E.G. stock and the stock is distributed by the transferee pursuant to a plan of reorganization.[54] This limitation has the effect of causing exchanges of E.G. stock that are part of an asset reorganization to be covered only by the third Targeted Transaction, which, as noted above, also imposes limitations on its application.

A debt instrument treated as stock under this rule is treated as stock from the time the debt instrument is issued.[55]

Funding Rule for Debt Recharacterization

Under the funding rule, debt is subject to recharacterization as equity if it is a "principal purpose debt instrument."[56] This funding rule adds a great deal of complexity to the regulations. However, the Treasury felt that the additional rule was necessary.

> Without these funding provisions, taxpayers that otherwise would have issued a debt instrument in a one-step [Targeted Transaction] . . . would be able to use multi-step transactions to avoid the application of these proposed regulations while achieving economically similar outcomes. For example, a wholly-owned subsidiary that otherwise would have distributed a debt instrument to its parent

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[52] Prop. Treas. Reg. §1.385-1(e).

[53] Prop. Treas. Reg. §1.385-3(b)(2).

[54] Prop. Treas. Reg. §1.385-3(f)(5).

[55] Prop. Treas. Reg. §1.385-3(d)(1)(i).

[56] Prop. Treas. Reg. §1.385-3(b)(3)(i).

> corporation in a distribution could, absent these rules, borrow cash from its parent and later distribute that cash to its parent in a transaction that is purported to be independent from the borrowing.[57]

A principal purpose debt instrument is a debt instrument issued with a principal purpose of funding one of the following distributions or acquisitions ("Targeted Funding Transactions"):

- A *distribution* of cash or property by the funded member to another E.G. member
- An *acquisition* of *stock* of another E.G. member for cash or property, other than in an exempt exchange (as defined above)
- An *acquisition* of *assets* of another E.G. member for cash or property in an asset reorganization, *but* only to the extent that, pursuant to the plan, a shareholder that is a member of the E.G. immediately before the reorganization receives cash or other property within the meaning of Code §356 with respect to its stock in the E.G. member who transferred assets to the funded member.[58]

"Under the funding rule, debt is subject to recharacterization as equity if it is a principal purpose debt instrument."

For example, if a foreign parent corporation lends $1,000 of cash to its wholly owned U.S. corporate subsidiary and one week later the U.S. subsidiary distributes the $1,000 cash back to the foreign parent as part of a pre-arranged plan, the funding rule applies and the debt instrument would be recharacterized as equity.

The principal purpose of the debt issuance is determined based on facts and circumstances.[59] However, the funding rule contains an irrebuttable presumption that an instrument is a principal purpose debt instrument if the debt is issued at any time during the 72-month period beginning 36 months before and ending 36 months after the issuing member makes a distribution or acquisition that is considered a Targeted Funding Transaction.[60] For example, if a foreign parent corporation lends $1,000 cash to its wholly owned U.S. corporate subsidiary and 30 months later, the U.S. subsidiary distributes $1,000 cash back to the foreign parent but *not* as part of a pre-arranged plan, then this 72-month *per se* funding rule would apply and the debt instrument is recharacterized as equity.

At the A.B.A. Meeting, the International Tax Counsel indicated that adoption of this 72-month *per se* rule provides for ease of administration and allows for implementation of the funding rule without the difficult task of determining the principal purpose based on facts and circumstances. However, this same rule may catch transactions that were not structured with any purpose of avoiding the debt recharacterization rules. In these cases, taxpayers must rely on the limited exceptions and exclusions to these rules provided in the regulations that are discussed below.

There is an exception from this 72-month *per se* rule for debt instruments arising in the ordinary course of the issuing member's trade or business in connection with the purchase of property or receipt of services (*e.g.*, accounts payable). This ordinary

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[57] REG 108060-15, Background, VI(C)(5) (April 4, 2016).

[58] Prop. Treas. Reg. §1.385-3(b)(3)(ii).

[59] Prop. Treas. Reg. §1.385-3(b)(3)(iv)(A).

[60] Prop. Treas. Reg. §1.385-3(b)(3)(iv)(B)(1).

course exception only applies if (i) the debt instrument reflects an amount that is currently deductible under Code §162 or it is currently included in the issuer's cost of goods sold or inventory; and (ii) the amount of the debt obligation does not exceed an amount that would be ordinary and necessary if it were owed to an unrelated person.[61] If this exception applies in lieu of the 72-month *per se* rule, this ordinary course debt instrument can still be challenged under the general principal purpose test.

A debt instrument, treated as stock under the funding rule, is treated as stock in the year when the debt instrument is issued, but only if it is issued in the same year as the Targeted Funding Transaction, or in a subsequent year.[62] However, if the debt instrument is issued in a taxable year prior to that of the Targeted Funding Transaction, the debt instrument is respected as debt until the date of the Targeted Funding Transaction.[63]

Exclusions

Three major types of borrowings are excluded from the general rule and the funding rule.

First, an exception exists if a threshold amount of debt does not exist. Under this exception, debt is not recharacterized if, immediately after the debt is issued, the aggregate adjusted issue price of all such E.G. debt held by members of the E.G. group does not exceed $50 million.[64]

Second, debt issued by an E.G. member that may be recharacterized as equity under the general rule is *reduced* by the member's current year E&P.[65] To illustrate, if a U.S. subsidiary distributes a $1,000 note to its foreign parent and the U.S. subsidiary has $1,000 of current E&P for that year, the note continues to be characterized as a debt instrument for U.S. tax purposes, and accordingly, the issuance of the note continues to be treated as a distribution of $1,000 that is taxable as a dividend. However, if the U.S. subsidiary has $700 of current E&P, only the portion of the debt instrument in excess of such current E&P (*i.e.*, $300) is recharacterized as equity of the issuer of the subsidiary. The exception applies to $700 of the $1,000 face amount of the note. Note that the exception is not extended to accumulated E&P, which cannot be used to fit within the exception.

Because the funding rule is subject to the E&P exception,[66] a foreign parent corporation that lends $1,000 cash to its wholly-owned U.S. corporate subsidiary is not deemed to receive stock of the subsidiary if the latter distributes $1,000 to the parent corporation within the following 36 months and in the year of the distribution, the U.S. subsidiary has $1,000 of current E&P.

Complications exist in applying the current E&P exception where more than one distribution or acquisition occurs in a single taxable year. The proposed regulations

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61 Prop. Treas. Reg. §1.385-3(b)(3)(iv)(B)(2).

62 Prop. Treas. Reg. §1.385-3(d)(1)(i).

63 Prop. Treas. Reg. §1.385-3(d)(1)(ii).

64 Prop. Treas. Reg. §1,385-3(c)(2).

65 Prop. Treas. Reg. §1,385-3(c)(1).

66 Prop. Treas. Reg. §1.385-3(g)(3), Ex. 17(ii), Analysis (C).

contain an ordering rule under which the current year E&P exception is applied to the various transactions in the order in which each occurred.[67] Consider the case of a U.S. subsidiary that makes a distribution of $30,000 to its foreign parent on March 1 and a distribution of a $19,000 note to its foreign parent on July 1. The U.S. subsidiary has $35,000 of current E&P for that year. Under the ordering rule, the $30,000 cash distribution comes from $30,000 of current E&P leaving only $5,000 of current E&P to cover the $19,000 note. The remaining $14,000 of the note is caught by the general rule and characterized as equity.[68]

At the A.B.A. Meeting, practitioners expressed concern about the narrowness of this exception, which would not apply to distributions made shortly after year-end that are attributable to the prior year's E&P, as well as concern about how this exception will be applied. In response to these concerns, the International Tax Counsel indicated that the current E&P exception may need some modifications to better protect taxpayer actions not principally motivated by avoidance of these rules.

"At the A.B.A. Meeting, practitioners expressed concern about the narrowness of the current year E&P exception, which would not apply to distributions made shortly after year-end that are attributable to the prior year's E&P."

Third, the proposed regulations contain a more limited exception for funded acquisitions of subsidiary stock.[69] This exception applies where the acquisition results from a transfer of property by a funded member (the transferor) to an E.G. member (the issuer) in exchange for stock of the issuer. The exception applies only where the transferor holds, directly or indirectly, more than 50% of the total combined voting power of all classes of stock of the issuer entitled to vote and more than 50% of the total value of the stock of the issuer for the 36-month period immediately following the issuance of the shares.

Cash Pooling and Treasury Centers

When issuing these proposed regulations, the Treasury requested comments regarding the need for special rules that would be applicable for cash pools, cash sweeps, and similar arrangements that are used to manage cash of an E.G.[70] Cash pooling is a cash management system that allows a group of related corporations to combine the credit and debit positions of various member into one account to reduce costs and enhance flexibility in managing group liquidity.[71]

At the A.B.A. Meeting, a practitioner requested that the Treasury not apply the debt recharacterization rules to cash pooling arrangements or treasury centers used by corporate groups. The International Tax Counsel indicated support for an exclusion covering cash pooling and cash sweeps, but not to treasury centers. Treasury centers should be viewed differently because they deal with longer-term needs.

Anti-abuse Rule

An anti-abuse rule is also included in the proposed regulations.[72] It provides that a debt instrument will be treated as stock if it is issued with a principal purpose of avoiding the application of the proposed regulations. In addition, other interests that

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67 Prop. Treas. Reg. §1,385-3(c)(1).

68 Prop. Treas. Reg. §1.385-3(g)(3), Ex. 17(ii), Analysis (C).

69 Prop. Treas. Reg. §1,385-3(c)(3).

70 REG 108060-15, Comments & Public Hearing (April 4, 2016).

71 "What Is Cash Pooling? Definition and Meaning," InvestorWords.

72 Prop. Treas. Reg. §1.385-3(b)(4).

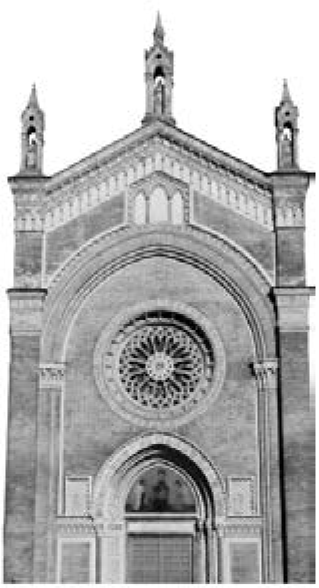
are not debt instruments for purposes of these rules (*e.g.*, contracts to which Code §483 applies or non-periodic swap payments) will be treated as stock if issued with the principal purpose of avoiding the application of these rules. A non-exhaustive list of illustrative examples is provided in the proposed regulations.[73]

Partnerships

To prevent avoidance of these rules through the use of partnerships, the new rules do not treat a controlled partnership as an entity, but rather they take an aggregate approach to controlled partnerships.[74] For example, when an E.G. member becomes a partner in a controlled partnership, the member is treated as acquiring its proportionate share of the controlled partnership's assets. A partnership is a controlled partnership if one or more members of an E.G. own 80% or more of the interests in the capital or profits of the partnership, either directly or indirectly.

Disregarded Entity

A debt instrument issued by a disregarded entity ("D.R.E."), that is treated as stock under these rules, is treated as stock of the sole member of the D.R.E. rather than as an equity interest in the D.R.E.[75] At the A.B.A. Meeting, one practitioner observed that this result is different than the treatment of a D.R.E. debt instrument subject to the documentation rules that is recharacterized as an equity interest in the D.R.E.[76] Responding to this observation, a senior counsel for the Office of International Tax Counsel, said that the Treasury was attempting to provide a more taxpayer-friendly result under the debt recharacterization rules. By taking such action, the regulations avoid creating an added entity, but only for purposes of the debt recharacterization rule.



Debt Instruments that Leave the E.G.

When (i) a debt instrument, that is treated as stock under these rules, is transferred to a person that is not an E.G. member or (ii) the obligor with respect to such debt instrument ceases to be an E.G. member, the interest ceases to be treated as stock.[77]

Effective Date

If finalized, the new rules regarding classification of certain debt as equity generally would apply to any debt instrument issued on or after April 4, 2016.[78]

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[73] Prop. Treas. Reg. §1.385-3(b)(4). *E.g.*, the anti-abuse rule may apply if a debt instrument is issued to, and later acquired from, a person that is not a member of the issuer's E.G., and it is issued with the principal purpose of avoiding the application of the proposed regulations.

[74] Prop. Treas. Reg. §1.385-3(d)(5).

[75] Prop. Treas. Reg. §1.385-3(d)(6).

[76] Prop. Treas. Reg. §1.385-2(c)(5).

[77] Prop. Treas. Reg. §1.385-3(d)(2).

[78] Prop. Treas. Reg. §1.385-3(h). This new rule will also apply to any debt instrument treated as or deemed to be issued before April 4, 2016, as a result of a "check-the-box" entity classification election that is made or filed on or after April 4, 2016.

DOCUMENTATION REQUIREMENTS

Background

Prop. Treas. Reg. §1.385-2 addresses the documentation and information requirements for a debt instrument issued between related parties to be treated as true debt for tax purposes. The Treasury is exercising its regulatory authority granted under Code §385(a) to treat the timely preparation and maintenance of this documentation as a necessary factor to be taken into account in determining if the interest is characterized as stock or indebtedness.

Compliance with these rules is not, however, a guarantee that the I.R.S. will treat the related-party debt as true debt for tax purposes. The common law Federal income tax principles discussed earlier still remain, and the documentation requirements under the rules are not determinative as to true debt characterization.

Debt Instruments Subject to These Documentation Rules

The documentation rules only apply to expanded group interests ("E.G.I.'s"), which are applicable instruments that are issued and held by members of an E.G.[79] There is no requirement that they be issued in connection with an inversion or any other specific transaction, so this rule has widespread impact. The aforementioned definition of an E.G. generally applies in this context as well. Thus, debt held by a controlled partnership will be subject to these rules.[80]

An E.G.I. only applies to applicable instruments that are interests issued in the form of debt instruments.[81] These rules are designed for traditional debt instruments. The proposed regulations reserved issuing guidance on the treatment of instruments that may be treated as debt for tax purposes but are not issued in the form of debt.[82] Comments are requested on how to address these other instruments.

These rules only apply to large taxpayer groups. An E.G.I. is subject to these rules only if (i) the stock of any member in the E.G. is publicly traded; (ii) all or any portion of the E.G.'s financial results are reported on financial statements with total assets exceeding $100 million; or (iii) the E.G.'s financial results are reported on financial statements that reflect annual total revenue that exceeds $50 million.[83] Only applicable financial statements, prepared within three years of the E.G.I. becoming subject to these rules, are relevant for determining whether an E.G.I. is subject to these rules.[84]

In response to practitioner comments at the A.B.A. Meeting, Marjorie Rollinson, Associate Chief Counsel (International) for the I.R.S., indicated that adoption of the documentation rule was reasonable and within the Treasury's power

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79 Prop. Treas. Reg. §1.385-2(a)(4)(ii).

80 See text accompanying note 70 *supra.*

81 Prop. Treas. Reg. §1.385-2(a)(4)(i).

82 Prop. Treas. Reg. §1.385-2(a)(4)(i)(B). Neither the Proposed Regulation nor the accompanying Treasury explanation gave examples of these unique debt instruments.

83 Prop. Treas. Reg. §1.385-2(a)(2).

84 Prop. Treas. Reg. §1.385-2(a)(4)(iv).

under Code §385. It was recognized, however, that application of the documentation rules to loans between two foreign entities that are members of an E.G. may impose a harsh burden and that the Treasury would consider comments that these rules not apply in this particular situation.

Proposed Documentation Requirements

The documentation rules are organized into four requirements, discussed below. The documentation must be maintained for all taxable years that the E.G.I. is outstanding, and it must be retained until the period of limitations expires on all returns to which the Federal tax treatment of the E.G.I. is relevant. While these four requirements represent fundamental case law principles for determining if an instrument is genuine tax indebtedness, they are now a mandatory component of true debt tax treatment, rather than relevant factors for making this determination.

The first requirement is there must be a binding obligation to repay the funds advanced. The rules require evidence in the form of a timely prepared written document executed by the parties.[85]

"The documentation rules only apply to E.G.I.'s. . . . There is no requirement that they be issued in connection with an inversion or any other specific transaction, so this rule has widespread impact."

The second requirement is for the loan agreement (or other written document) to delineate the creditor's rights to enforce the terms concerning the issuer's obligation to repay.[86] The creditor will need to have the legal rights to enforce the terms of the E.G.I. Typical creditor rights include the right to trigger a default, the right to accelerate payments, and the superior right over shareholders to share in the assets of the issuer in the event that the issuer is dissolved or liquidated. The impact of this requirement is that a one-page note evidencing the loan will likely no longer serve as adequate documentation.

The third requirement is a reasonable expectation of repayment by the issuer of the loan.[87] The proposed regulations indicate documentation requirements such as cash flow projections, financial statements, business forecasts, asset appraisals, determination of debt to-equity and other relevant financial ratios of the issuer. This documentation may not have been prepared in the past. Special rules are provided to address disregarded entities that issue an E.G.I. and whether the assets of the sole member of such entity can be considered in determining whether repayment is expected.

The final requirement is there must be evidence of a genuine debtor-creditor relationship.[88] The taxpayer asserting debt treatment must prepare and maintain timely evidence of an ongoing debtor-creditor relationship. This documentation can take two forms. In the case of an issuer that complied with the terms of the E.G.I., the documentation must include timely prepared documentation of any payments on which the taxpayer relies to establish such treatment under general Federal tax principles. If the issuer failed to comply with the terms of the E.G.I., either by failing to make required payments or by otherwise suffering an event of default under the terms of the E.G.I., the documentation must include evidence of the holder's reasonable exercise of the diligence and judgment of a creditor. The proposed regulations indicate acceptable forms of documentation, including evidence of the

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85 Prop. Treas. Reg. §1.385-2(b)(2)(i).

86 Prop. Treas. Reg. §1.385-2(b)(2)(ii).

87 Prop. Treas. Reg. §1.385-2(b)(2)(iii).

88 Prop. Treas. Reg. §1.385-2(b)(2)(iv).

holder's efforts to enforce the terms of the E.G.I., as well as evidence of any efforts to renegotiate the E.G.I.

Timing of Preparation of Documentation

The documentation generally must be prepared no later than 30 calendar days after the later of (i) the date that the instrument becomes an E.G.I. or (ii) the date that the E.G. member becomes an issuer with respect to an E.G.I. The preparation of the documentation of the debtor-creditor relationship can be prepared up to 120 calendar days after the payment or relevant event occurred, which gives more time to comply.[89]

Revolving Credit Agreements and Cash Pooling

The documentation requirements provide special rules for determining the timeliness of documentation preparation in the case of certain revolving credit agreements and similar arrangements, as well as cash pooling arrangements. The rules generally look to the documents pursuant to which the arrangements were established.[90]

Reasonable Cause Exception

If a taxpayer can show that failure to satisfy these rules is due to reasonable cause then appropriate modifications may be made to the requirements of this section in determining whether the requirements of this section have been met.[91] While the reasonable cause exception may benefit taxpayers in the event of an audit, it is not useful for planning purposes.

Effective Date

This documentation rule will apply to any debt instrument issued on or after publication of final regulations under Code §385.[92]

BIFURCATION RULE

Prop. Treas. Reg. §1.385-1(d) gives the I.R.S. the ability to recast only a portion of a debt instrument as equity and treat the remaining portion as debt (the "bifurcation rule"), instead of taking an "all-or-nothing" approach, as under current law. According to the Treasury and I.R.S., the existing all-or-nothing approach frequently does not reflect the economic substance of related-party debt.[93]

This bifurcation rule applies to a modified expanded group ("M.E.G."),[94]

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89 Prop. Treas. Reg. §1.385-2(a)(3)(i).

90 Prop. Treas. Reg. §1.385-2(b)(3)(iii).

91 Prop. Treas. Reg. §1.385-2(c)(1). The regulation adds that "[t]he principles of §301.6724-1 of this chapter apply in interpreting whether reasonable cause exists in any particular case."

92 Prop. Treas. Reg. §1.385-2(f). This new rule will also apply to any debt instrument treated as debt issued or deemed issued before April 4, 2016, as a result of a check-the-box entity classification election that is made or filed on or after April 4, 2016.

93 REG 108060-15, Background, VI(A) April 4, 2016).

94 Prop. Treas. Reg. §1.385-1(d)(2).

which covers a broader range of taxpayers than those affected by the other Code §385 rules. An M.E.G. means an E.G. where the threshold for determining relatedness is 50% ownership, not 80% as otherwise stipulated in the new rules.[95] Notably, the Treasury declined to apply this bifurcation rule to debt between unrelated persons since that "could result in uncertainty in the capital markets."[96]

Unlike the inversion guidance, which contained many illustrative examples, the new bifurcation rule does not provide much explanation as to when bifurcation may be appropriate. The only guidance is the following:

> For example, if the Commissioner's analysis supports a reasonable expectation that, as of the issuance of the E.G.I., only a portion of the principal amount of an E.G.I. will be repaid and the Commissioner determines that the E.G.I. should be treated as indebtedness in part and stock in part, the E.G.I. may be treated as indebtedness in part and stock in part in accordance with such determination, provided the requirements of §1.385-2, if applicable, are otherwise satisfied and the application of federal tax principles supports this treatment.[97]

Effective Date

This bifurcation rule will apply to any debt instrument issued on or after publication of final regulations under Code §385.[98]

CONSOLIDATED GROUPS

As noted earlier,[99] these new rules do not apply to debt issued between members of a U.S. consolidated group (a "consolidated group debt instrument"), since all the members are treated as a single corporation.[100] Prop. Treas. Reg. §1.385-4 was adopted to address situations where a debt instrument becomes or ceases to be a consolidated group debt instrument.

If a consolidated group debt instrument was not initially treated as stock solely due to the rule treating all members of a consolidated group as a single corporation, then the debt instrument is referred to as an "exempt consolidated group debt instrument." If either the creditor or debtor of an exempt consolidated group debt instrument leaves the consolidated group then the debt instrument is deemed to be exchanged for stock immediately after the departing member leaves the group.[101] By contrast, if a consolidated group debt instrument would not have been treated as equity under these rules in any event ("nonexempt consolidated group debt instrument") then such debt instrument retains its character as debt when either the

95 Prop. Treas. Reg. §1.385-1(b)(5).

96 REG 108060-15, Background, VI(A) April 4, 2016).

97 Prop. Treas. Reg. §1.385-1(d)(1).

98 Prop. Treas. Reg. §1.385-1(f). This new rule will also apply to any debt instrument treated as debt issued or deemed issued before April 4, 2016, as a result of a check-the-box entity classification election that is made or filed on or after April 4, 2016.

99 See text accompanying note 48 *supra*.

100 Prop. Treas. Reg. §1.385-1(e).

101 Prop. Treas. Reg. §1.385-4(b)(1)(i).

debtor or creditor leaves the group. However, a nonexempt consolidated group debt instrument can be treated as equity under the funding rule[102] discussed earlier as a result of a later distribution or acquisition.[103]

When a member of a consolidated group transfers a consolidated group debt instrument to a member of the E.G. that is not part of the consolidated group, the debt instrument is treated as newly issued by the debtor or issuer that is held by the transferee E.G. member. The deemed date of issuance is the date of transfer.[104] That new issuance must then be tested under these rules to determine if debt status should be retained for tax purposes. Detailed examples are included in the regulations to assist in this determination.[105]

"These proposed Code §385 regulations cast a wide net and various related-party debt is affected. These rules go far beyond what was previously thought sufficient for related-party debt instruments to be respected as true debt."

When a debt instrument that was treated as stock under the debt recharacterization rule of Prop. Treas. Reg. §1.385-3 becomes a consolidated group debt instrument, the issuer is treated as issuing a new debt instrument to the holder in exchange for the debt instrument that was treated as stock under Treas. Reg. §1.385-3.[106]

Effective Date

These consolidation rules generally apply to any debt instrument issued on or after April 4, 2016,[107] which mirrors the effective date of the debt recharacterization rule of Prop. Treas. Reg. §1.385-3.

CONCLUSION

These proposed Code §385 regulations cast a wide net and various related-party debt is affected. These rules go far beyond what was previously thought sufficient for related-party debt instruments to be respected as true debt for tax purposes. While previously proposed Code §385 regulations were withdrawn in 1983,[108] it is likely that these regulations will be finalized in whole or in part before year-end. Given the effective dates of these new rules, and the need to accommodate their many new requirements, planning should begin immediately and be completed before year-end to ensure that related-party debt retains its tax character and usefulness.

As stated at the beginning of the article, the International Tax Counsel emphasized the current view of the Treasury Department as to the importance of issuing final regulations this year. A broader question that was not asked is the length of time such final regulations will remain in existence depending on the outcome of the Presidential election. Are these rules an anomaly or do they preview the future of U.S. tax policy?

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102 Prop. Treas. Reg. §1.385-3(b)(3)(ii)

103 Prop. Treas. Reg. §1.385-4(b)(1)(ii).

104 Prop. Treas. Reg. §1.385-4(b)(2).

105 Prop. Treas. Reg. §1.385-4(d), Ex. 1 and 2.

106 Prop. Treas. Reg. §1.385-4(c).

107 Prop. Treas. Reg. §1.385-4(e). This new rule will also apply to any debt instrument treated as debt issued or deemed issued before April 4, 2016, as a result of a check-the-box entity classification election that is made or filed on or after April 4, 2016.

108 T.D. 7920, 1983-2 C.B. 69.

U.S. ON THE BLACKLIST – IS DELAWARE A TAX HAVEN?

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Tags
Beneficial Owner
Blacklist
CbC Reporting
Delaware
Tax Haven
Tax Avoidance

In reaction to the Panama Papers revelations, many European countries have increased what were already fierce actions towards combatting global tax evasion. Notably, the European Commission has gone so far as to draft a blacklist of tax havens based on the O.E.C.D.'s Common Reporting Standard ("C.R.S.") – informally also referred to as "G.A.T.C.A.", *i.e.*, the globalization of F.A.T.C.A. – and Base Erosion and Profit Shifting ("B.E.P.S.") initiatives.

The European Parliament and several E.U. Member States contended that if the U.S. does not implement the C.R.S. and B.E.P.S. Project recommendations, the country should be declared a tax haven and added to the European Commission's new blacklist. E.U. Member States have even demanded that Delaware and Nevada be required to disclose the beneficial owners of the companies formed in those states.[1]

The blacklist is expected to be finalized by the end of 2016. Under the European Commission's proposed country-by-country ("CbC") reporting requirements, any company with business activities in a country on the blacklist would be required to disclose profits earned and taxes paid in that jurisdiction.[2] If the U.S. is blacklisted, this would impose an even greater administrative burden on U.S. companies, which are already subject to numerous reporting requirements under U.S. domestic tax law, by requiring them to provide additional reporting to the E.U. Other E.U. proposals include the creation of a beneficial ownership registry, to be exchanged amongst the E.U. Member States, and the expansion of the E.U.'s Anti-Tax Avoidance Directive and Anti-Money Laundering Directive.[3]

U.S. REACTION TO THE PANAMA PAPERS – BENEFICIAL OWNERSHIP REGISTRY

In comparison, the U.S. reaction to the Panama Papers has not been so bold,[4] and the revelations did not appear to affect the country's stance vis-a-vis the international rush towards corporate public reporting. While roughly 100 nations have agreed

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1 Joe Kirwin, "E.U. Ministers Back Exchanging Beneficial Ownership Registries," *Bloomberg BNA, International Tax Monitor*, April 25, 2016.

2 See in detail Kenneth Lobo and Michael Peggs, "Country-by-Country Reporting – Where Are We Going?," *Insights* 3, no. 4 (2016).

3 *Id.*

4 While the acting assistant attorney general in the Department of Justice's Tax Division declined to comment on the consequences of the Panama Papers, the deputy chief in the Internal Revenue Service's Criminal Investigation Division made clear that scrutinizing international tax evasion cases will be given absolute priority. See *Bloomberg BNA, International Tax Monitor*, May 10, 2016.

to implement the C.R.S., the U.S. has yet to sign on. At this stage, there does not seem to be much Congressional support for adopting the C.R.S. and B.E.P.S. Project recommendations, and the adversarial situation is further compounded by the fact that many congressmen view the E.U. State Aid investigations as unfairly targeting U.S. multinational companies.

Even if it is not following the lead of the O.E.C.D. or the E.U., the U.S. has taken its own actions to fight tax evasion: In his May 5 letter to Congress, U.S. Treasury Secretary Jacob Lew referred to F.A.T.C.A. as the "critical tool in the fight against tax evasion," which resulted in the creation of the C.R.S. on an international level. Nevertheless, Treasury Secretary Lew acknowledged that current U.S. measures were not without their flaws, and he called upon Congress to pass proposed legislation, which would require states to report beneficial ownership, to further counter money laundering and tax evasion.[5] Currently, the U.S. government does not require any U.S. states to report the beneficial owners of entities within their jurisdictions.

It is unclear how much Congressional support there is for such beneficial ownership registries, as previous proposals by the Obama Administration have been blocked by Congress and other U.S. agencies. For example, instead of having states require companies to disclose their beneficial owners during the registration process, the Obama Administration has proposed legislation that would apply to all states and would require every U.S. business entity to obtain a tax identification number that could be shared with the Treasury Department and other law enforcement agencies.[6]

Independent of the Treasury Department's actions, Senator Ron Wyden (D-OR) of the Senate Finance Committee has requested that the state secretaries of Nevada and Wyoming provide a specific list of information about the beneficial owners of entities linked to the law firm Mossack Fonseca through the Panama Papers. The senator cited his growing concern about anonymous shell companies concealing illegal activities and requested the information be provided by June 3. This would be no small feat, as there are over 1,000 entities registered in Nevada that appear in the Panama Papers, and an additional 24 entities registered in Wyoming.[7]

THE U.S. IS A TAX HAVEN? – FEDERAL REPORTING REQUIREMENTS

The E.U. contention that the U.S. should be blacklisted as a tax haven seems to be no more than an overreaction to the Panama Papers. Not only has the U.S. Federal government spearheaded the global movement towards financial information sharing with initiatives like F.A.T.C.A., but the U.S. has some of the most extensive reporting requirements in the world.

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5 Kevin Bell, "*Treasury Targets Foreign-Owned LLCs to Battle Tax Evasion*," *Bloomberg BNA, International Tax Monitor*, May 6, 2016. Further proposed measures include providing full reciprocity with F.A.T.C.A. partners, rules on disregarded entities, a final rule requiring banks to obtain more information on account owners, and approval of bilateral tax treaties currently pending in the Senate.

6 David Kocieniewski, "Delaware's Opacity Industry Provides U.S. Onshore Tax Haven," *Bloomberg BNA, Daily Tax Report*, April 27, 2016.

7 "Nevada & Wyoming Asked to Provide Information on Entities Linked to 'Panama Papers,'" *Checkpoint, International Taxes Weekly*, May 17, 2016.

There is a low monetary threshold that triggers a U.S. person's requirement to file certain forms that disclose connections with foreign entities or assets. The most commonly used forms are described below.

> ***"Not only has the U.S. Federal government spearheaded the global movement towards financial information sharing with initiatives like F.A.T.C.A., but the U.S. has some of the most extensive reporting requirements in the world."***

Form 5471

Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, must be filed by certain U.S. persons that acquire or own interests in foreign corporations. Generally, Form 5471 must be filed annually if the U.S. person owns at least 10% of the voting power of a foreign corporation that is a controlled foreign corporation ("C.F.C."). The penalties for failing to file Form 5471 can be substantial.

Form 8938

Any individual with an interest in one or more specified foreign financial assets that have a value greater than (i) $50,000 on the last day of the taxable year or (ii) $75,000 at any time during such year (with higher amounts applying based on tax filing status and residency) is obligated to disclose those interests on Form 8938, *Statement of Specified Foreign Financial Assets*.

Applicable foreign financial assets generally include any depository or custodial accounts that are maintained by a foreign financial institution and any other financial instrument or contract that is held for investment purposes, including stock and securities. The penalties for failing to file Form 8938 can also be substantial.

FinCEN Form 114

U.S. persons who have a financial interest in or signature or other authority over a financial account in a foreign country must report the account annually to the Treasury Department, if the aggregate value of all foreign financial accounts exceeds $10,000 at any time during the calendar year. An individual is deemed to have a financial interest in a foreign financial account held by a corporation in which the individual owns, directly or indirectly, more than 50% of the total value of shares of stock or more than 50% of the voting power of all shares of stock. Reporting is effected on FinCEN Form 114, commonly known as the F.B.A.R., which is due by June 30 following the close of the calendar year.

Form 8621

Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or a Qualified Electing Fund*, reports ownership of, or certain transactions with, a passive foreign investment company ("P.F.I.C.").

Under Code §1298(f), each U.S. person who is a P.F.I.C. shareholder must file an annual report containing such information as the Secretary may require. Individuals who own at least 50% of the value of the stock of a foreign corporation are considered to own a proportionate amount (by value) of any stock owned directly or indirectly by the foreign corporation.

Form 926

Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*, is used to report certain transfers of property to a foreign corporation required by Code

§6038B. A U.S. person that transfers cash to a foreign corporation must report the transfer on Form 926 if (i) immediately after the transfer the person holds, directly or indirectly, at least 10% of the total voting power or the total value of the foreign corporation, or (ii) the amount of cash transferred by the person to the foreign corporation during the 12-month period ending on the date of the transfer exceeds $100,000.

DELAWARE TAX HAVEN DEBATE

For years, tax professionals have debated whether the state of Delaware is a tax haven. The over 200,000 "offshore" tax avoidance structures revealed in the Panama Papers have rejuvenated this debate.

That Delaware is attracting businesses cannot be denied. Notably, over 285,000 companies are currently registered with the same address at 1209 North Orange Street in Wilmington, Delaware. This address is the most popular address in the world and home to some of America's biggest companies, including Walmart, General Electric, American Airlines, and PepsiCo; and it is even home to entities owned by U.S. presidential candidates Hillary Clinton and Donald Trump.[8]

One of the reasons that Delaware is attractive to businesses lies in its state tax system. While Delaware imposes an income tax of 8.7% on corporations doing business in or deriving income from property located in Delaware,[9] corporations are generally exempt from corporate income tax if the activities within Delaware are limited to the maintenance and management of intangible investments.[10] While entities incorporated in Delaware that do not conduct business in the state are not subject to corporate income tax, they must pay the franchise tax to the Delaware Department of State.[11] Delaware does not impose a sales tax.

Delaware has a fast and simple incorporation process that has allowed for more than one million entities to be registered in the state. The process merely requires registering the entity's name and address, and paying a fee. As is the case for all U.S. states under current law, Delaware does not require the beneficial owners of its entities to be registered. Delaware law protects the confidentiality of its entities' owners.

While many shell companies in Delaware are created for legitimate reasons, including buying real estate without alerting competitors and creating business holding companies, Delaware's relaxed disclosure rules may also attract illegitimate shell companies. A company registered in Delaware can take advantage of business-friendly courts, strict secrecy rules, lack of sales tax, and corporate tax exemptions. The combination of these factors results in Delaware treading the line between allowing companies to be tax efficient and enabling tax evasion.

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8 Rupert Neate, "Trump and Clinton Share Delaware Tax 'Loophole' Address with 285,000 Firms," *The Guardian*, May 25, 2016.

9 Del. Code Ann. tit. 30, §1902(a). Delaware has a physical presence test to determine whether an entity has sufficient nexus to be subjected to its tax.

10 Del. Code Ann. tit. 30, §1902(b)(8).

11 Del. Code Ann. tit. 30, §1902(b)(6).

However, in view of extensive Federal reporting obligations and the high Federal income tax rate,[12] Delaware and other low-tax states[13] do not compare with international tax havens such as Hong Kong, Monaco, or Guernsey. Moreover, if the Treasury recommendations are pursued and Congress implements a Federal standard for reporting beneficial ownership information, it will hard to consider Delaware a tax haven because the owners of Delaware entities will be known and unable to untraceably shift income.

The Delaware Loophole

Under the Delaware state income tax regime, the "Delaware loophole" structure has allowed U.S. companies to shift income from states with high corporate tax rates. This tax loophole is also referred to as a "passive investment company," an "intangible holding company," and a "Geoffrey the Giraffe structure" (after the corporate mascot of children's retailer Toys"R"Us, which famously uses its Delaware subsidiary to avoid state income taxes).

Subsidiary Structure

The Delaware loophole is often a subsidiary structure in which a passive investment company is formed in Delaware and the parent company transfers all of its intangible property into the Delaware subsidiary. The Delaware subsidiary then licenses its intangible property back to the parent company, or affiliated sister companies, in exchange for royalty payments, which are tax-free in Delaware. The parent company claims the royalty payments as a business expense and deducts the expense from its state income tax. Thus, the company effectively reduces its taxable income, and no state income tax is paid on the royalties.[14]

Since interest payments are also tax-free, the Delaware loophole structure enables the Delaware subsidiary to loan money to its parent or sister companies. Again, this results in the parent or sister company a taking deduction on its state income tax return for the interest paid on the loan, and the Delaware subsidiary is not taxed on the interest income it receives.

Real Estate Structure

The real estate investment trust ("R.E.I.T.") structure is also used by large companies to avoid state income tax. Under Federal law, the dividends distributed from the R.E.I.T. to its investors are exempt from tax. Chain retailers have commonly used the R.E.I.T. to buy land on which to build their stores. The parent company pays rent to the R.E.I.T. and deducts the rent, as a business expense, from its state income tax. The R.E.I.T.'s income is distributed as a dividend, which is tax-exempt, back to the parent company. Delaware, Nevada, and Wyoming are all popular states to set

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12 The U.S. has one of the highest Federal income tax rates in the world, which applies to U.S. entities irrespective of the state of formation.

13 Other U.S. states that offer a low or zero corporate tax rate include Nevada, Wyoming, and South Dakota.

14 Institute for Local Self-Reliance, "Closing State Corporate Tax Loopholes: Combined Reporting," December 2015.

up R.E.I.T.'s because rental income is not subject to state income tax.[15]

Closing the Loophole

> **"Arguably, Delaware is a U.S. domestic tax haven – but it is not an international one."**

It is difficult to determine how much state income tax has been diverted to states like Delaware because the foregoing structures are legal and U.S. companies are not required to report transfers to their U.S. subsidiaries.[16] Smaller companies that do not operate in multiple states are left with a bigger state income tax burden because they do not have the means to create a Delaware subsidiary into which they could shift income. However, many states have closed the Delaware loophole by requiring corporations with sufficient nexus to file combined tax returns with their associated entities.[17] These combined tax returns require all of the companies' income earned within the U.S. and a worldwide basis to be reported on one state return.

CONCLUSION

The claim that Delaware is a tax haven is misplaced. Arguably, Delaware is a U.S. domestic, but not an international, tax haven. Whereas Delaware's advantageous state income tax regime directs millions of dollars in revenue away from other U.S. states, Federal income tax must still be paid – at one of the highest tax rates worldwide. Furthermore, Delaware-based entities must comply with extensive Federal reporting requirements. The main reason companies are formed in Delaware is due to its business-friendly corporate law. The corporate income tax exemptions provide an ancillary benefit.

Although no U.S. state is currently required to maintain beneficial ownership information, the proposals by the Treasury Department and the Senate Finance Committee suggest that a registry of certain beneficial owners may be implemented at the state level in the not too distant future. In view of these developments, the contention that any U.S. state, or the country as a whole, is a tax haven may soon be obsolete.

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15 *Id.*

16 According to one source, the cost to such states is estimated at more than $9 billion in lost revenue. See Neate, "Trump and Clinton."

17 "Closing State Corporate Tax Loopholes: Combined Reporting."

INBOUND §332 LIQUIDATIONS & INBOUND ASSET REORGANIZATIONS

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Tags
All Earnings and Profits Amount
Corporate Reorganization
Inbound §332 Liquidation
Inbound Asset Reorganization

When a wholly-owned domestic subsidiary corporation liquidates into its domestic parent corporation, the transaction is generally non-taxable under Code §§332 and 337. In addition, when the assets of a domestic target corporation are transferred to a domestic acquiring corporation in an asset reorganization under Code §368(a)(1) (such as an A-, C-, D-, or F-reorganization), the transaction is generally non-taxable under Code §§354 and 361.

However, special rules under Treas. Reg. §1.367(b)-3 apply when a *foreign* subsidiary corporation liquidates into its domestic parent corporation (an "inbound 332 liquidation") and when the assets of a *foreign* target corporation are transferred to a domestic acquiring corporation in an asset reorganization (an "inbound asset reorganization").

INCOME INCLUSION REQUIREMENT

When a domestic corporation ("Domestic Acquiror") acquires the assets of a foreign corporation ("Foreign Target") in a liquidation described in Code §332 or an asset acquisition described in Code §368(a)(1), generally the "U.S. shareholder" must include in income as a dividend the "all earnings and profits amount" with respect to its stock in Foreign Target.[1]

The term U.S. shareholder means any U.S. person who owns, directly or indirectly, 10% or more of the total combined voting power of all classes of stock in Foreign Target that are entitled to vote.[2] The all earnings and profits amount means the shareholder's *pro rata* share of the earnings and profits of Foreign Target.[3]

Example 1 – Inbound 332 Liquidation

Domestic Acquiror owns all of the outstanding stock of Foreign Target. The stock of Foreign Target has a value of $100, and Domestic Acquiror has a basis of $30 in that stock. The all earnings and profits amount attributable to Foreign Target stock owned by Domestic Acquiror is $75. Foreign Target has a basis of $50 in its assets. In a liquidation described in Code §332, Foreign Target distributes all of its property to Domestic Acquiror, and the stock held by Domestic Acquiror is canceled.[4]

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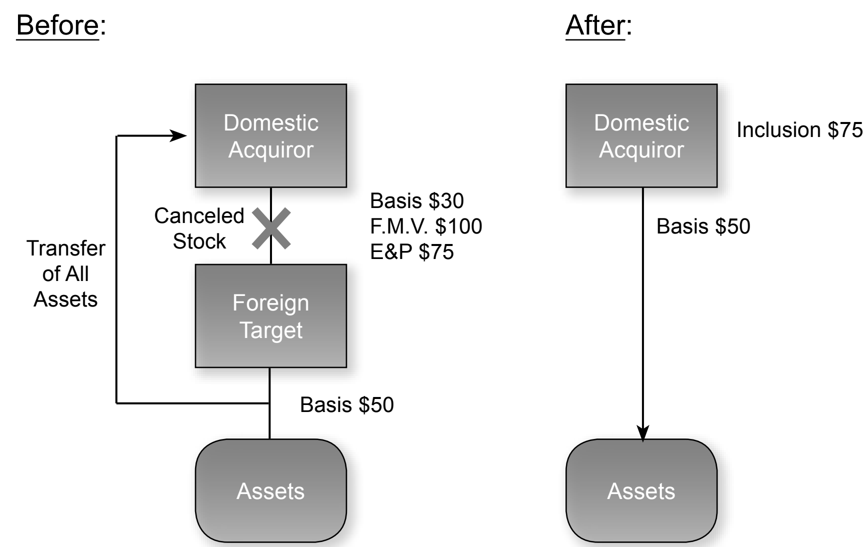
1 Treas. Reg. §1.367(b)-3(b)(3).

2 Treas. Reg. §1.367(b-3(b)(2) and Code §§951(b), 953(c)(1).

3 Treas. Reg. §1.367(b)-1(d).

4 Based on Example 2 of Treas. Reg. §1.367(b)-3(b).



Domestic Acquiror must include $75 in income as a deemed dividend from Foreign Target. Under Code §337(a) Foreign Target does not recognize gain or loss in the assets distributed to Domestic Acquiror, and under Code §334(b), Domestic Acquiror takes a basis of $50 in those assets. Because the requirements of Code §902 are met, Domestic Acquiror qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from Foreign Target.

Example 2 – Inbound 332 Liquidation with a Minority Shareholder

Domestic Acquiror owns 80% of the outstanding stock of Foreign Target, and it has owned this 80% interest since Foreign Target was incorporated. The remaining 20% of the outstanding stock of Foreign Target is owned by a person unrelated to Domestic Acquiror (the "Minority Shareholder"). The Foreign Target stock owned by Domestic Acquiror is valued at $80, and Domestic Acquiror has a basis of $24 in that stock. The Foreign Target stock owned by the Minority Shareholder is valued at $20, and the Minority Shareholder has a basis of $18 in that stock.

Foreign Target's only asset is land valued at $100, of which Foreign Target's basis is $50. Gain on the land would not generate earnings and profits that qualify for an exclusion[5] from earnings and profits for purposes of Code §1248. Foreign Target has earnings and profits of $20, of which $16 is attributable to the stock owned by Domestic Acquiror.

Foreign Target subdivides and distributes the land. The Minority Shareholder receives land with a value of $20 and a basis of $10. As part of the same transaction, Foreign Target distributes the remainder of the land to Domestic Acquiror in a liquidation described in Code §332. The Foreign Target stock, which was previously held by Domestic Acquiror and the Minority Shareholder, is canceled.[6]

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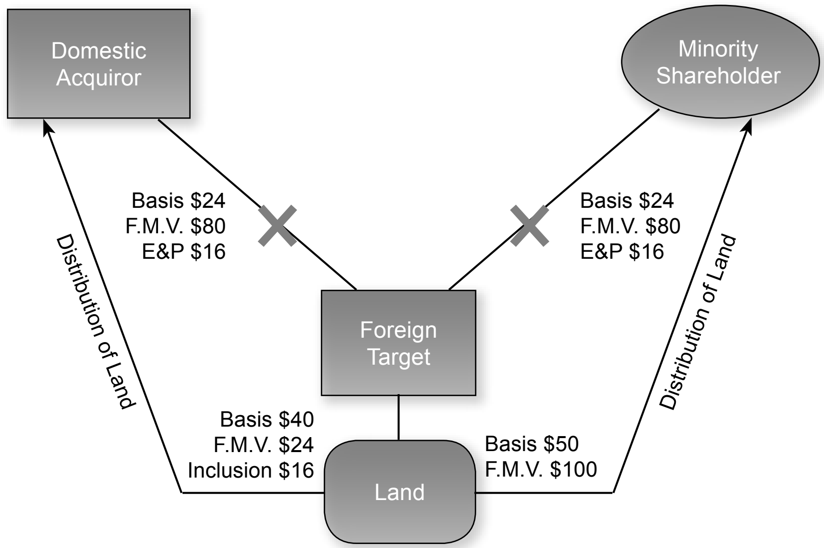
5 Code §1248(d).

6 Based on Example 3 of Treas. Reg. §1.367(b)-3(b).

> ***"Gain on the land would not generate earnings and profits that qualify for an exclusion from earnings and profits for purposes of Code §1248."***



Under Code §336, Foreign Target recognizes $10 of gain on the land distributed to the Minority Shareholder. Under Code §331, the Minority Shareholder recognizes $2 of gain on the stock of Foreign Target. If the Minority Shareholder is a U.S. person described in Code §1248(a)(2), the latter amount is included in the income of the Minority Shareholder as a dividend, to the extent provided in Code §1248. The $10 of gain recognized by Foreign Target increases its earnings and profits for purposes of computing the all earnings and profits amount, and as a result, an additional $8 (*i.e.*, 80% of $10) is considered to be attributable to the Foreign Target stock owned by Domestic Acquiror. Domestic Acquiror's all earnings and profits amount with respect to its stock in Foreign Target is $24 (*i.e.*, the initial all earnings and profits amount of $16 with respect to the Foreign Target stock held by Domestic Acquiror, plus the additional $8 resulting from Foreign Target's recognition of gain on the distribution to the Minority Shareholder). Domestic Acquiror must include the $24 all earnings and profits amount in income as a deemed dividend from Foreign Target.

Example 3 – Inbound Asset Reorganization

A domestic corporation ("D.C.1"), owns all of the outstanding stock of another domestic corporation ("D.C.2"). D.C.1 also owns all of the outstanding stock of a foreign corporation ("F.C."). The stock of F.C. has a value of $100, and D.C.1 has a basis of $30 in that stock. The assets of F.C. have a value of $100. The all earnings and profits amount with respect to the F.C. stock owned by D.C.1 is $20. In a reorganization described in Code §368(a)(1)(D), D.C.2 acquires all of the assets of F.C. solely in exchange for D.C.2 stock. F.C. distributes the D.C.2 stock to D.C.1, and the F.C. stock held by D.C.1 is canceled.[7]

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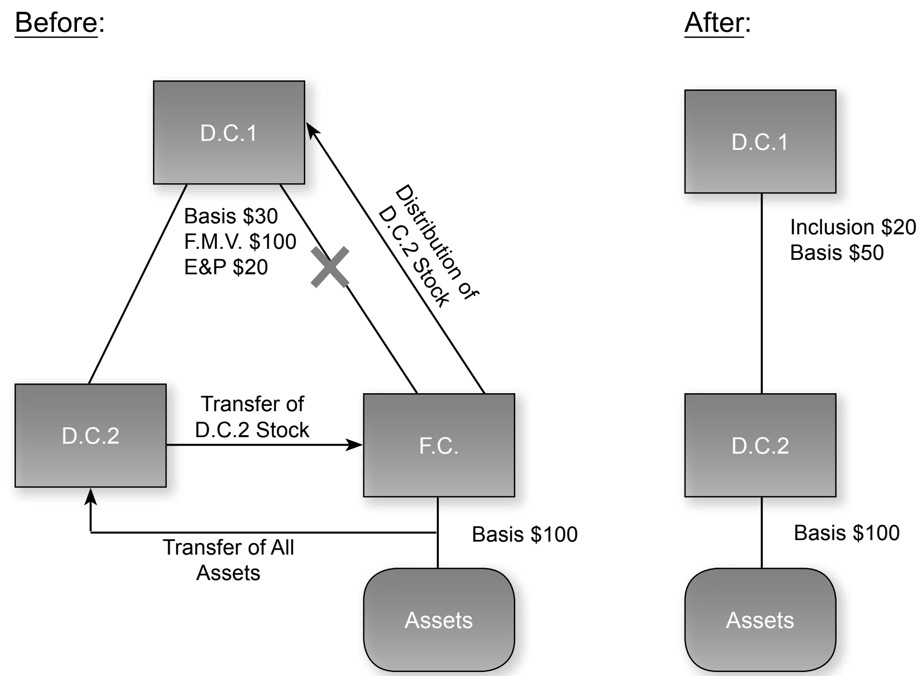
[7] Based on Example 4 of Treas. Reg. §1.367(b)-3(b).



D.C.1's income must include a $20 deemed dividend from F.C. Under Code §361, F.C. does not recognize gain or loss in (i) the assets transfered to D.C.2 or (ii) the D.C.2 stock distributed to D.C.1. Under Code §362(b), D.C.2 takes a basis in the acquired assets equal to F.C.'s basis therein. D.C.1 takes a basis of $50 (*i.e.*, the $30 basis in the stock of F.C., plus the $20 treated as a deemed dividend to D.C.1) in the D.C.2 stock that it receives in exchange for the stock of F.C.[8] The earnings and profits of F.C. are reduced by the $20 deemed dividend.[9]

U.S. PERSON WHO IS NOT A U.S. SHAREHOLDER

General Rule

If the Foreign Target stock is owned by a U.S. person who is not a U.S. shareholder (*i.e.*, a less than 10% shareholder), the general rule is that the U.S. person must recognize realized gain (but not loss) with respect to the stock of Foreign Target.[10] However, in lieu of recognizing gain, the U.S. person may elect to include a deemed dividend in its income, the amount of which reflects the all earnings and profits amount with respect to the stock in Foreign Target.[11] The election is available only if Foreign Target provides the U.S. person with the information needed to compute

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8 Treas. Reg. §1.367(b)-2(e)(3)(ii) and Code §358(a)(1).

9 Treas. Reg. §1.367(b)-2(e)(3)(iii) and Code §312(a).

10 Treas. Reg. §1.367(b)-3(c)(2).

11 Treas. Reg. §1.367(b)-3(c)(3).

the shareholder's all earnings and profits amount and the shareholder complies with the notice requirements in Treas. Reg. §1.367(b)-1(c).[12]

De Minimis Exception

U.S. persons who are not U.S. shareholders are not subject to the gain or income inclusion requirements if they own stock in Foreign Target that has a fair market value of less than $50,000.[13]

CARRYOVER OF FOREIGN TARGET EARNINGS AND PROFITS TO DOMESTIC ACQUIROR

"Special rules apply when a foreign subsidiary corporation liquidates into its domestic parent and when the assets of a foreign target corporation are transferred to a domestic acquiring corporation in an asset reorganization."

Earnings and profits of Foreign Target that are not included in income as a deemed dividend under the Code §367(b) regulations are carried over from Foreign Target to Domestic Acquiror,[14] but only to the extent that such earnings and profits are effectively connected with the conduct of a U.S. trade or business.[15] Other earnings and profits (or deficits in earnings and profits) of Foreign Target do not carry over to Domestic Acquiror, and as a result, they are eliminated.

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12 *Id.*

13 Treas. Reg. §1.367(b)-3(c)(4).

14 Code §381(c)(2).

15 Treas. Reg. §1.367(b)-3(f).

U.S. TAX RESIDENCY CERTIFICATION AND SPANISH WITHHOLDING TAX: EARLY APPLICATION RECOMMENDED

Authors
Christine Long
Beate Erwin

Tags
Form 6166
Form 8802
Spain
Tax Residency
U.S. Tax Residency Certification
Withholding Tax

Persons resident outside of Spain are subject to Spanish withholding tax on payments received from Spanish sources. This applies, *inter alia*, to payments to foreign authors.

However, the withholding tax may be reduced or eliminated under an applicable income tax treaty. Under the U.S.-Spain income tax treaty, relief from withholding tax for individuals requires that the recipient is a tax resident of the United States. Individuals are considered to be U.S. residents for Federal income tax purposes if they are either U.S. citizens, U.S. lawful permanent residents ("green card holders"), or meet the substantial presence test.[1]

To provide evidence on tax-resident status, and thus eligibility for treaty benefits, the U.S. person is required to obtain a Form 6166, *Certification of U.S. Tax Residency*, ("U.S. Certification") from the Internal Revenue Service (the "I.R.S.") and furnish the document to the Spanish payor. Unless a U.S. Certification is provided to the Spanish tax authorities on a timely basis − preferably by February of the respective calendar year − the Spanish payor must withhold the Spanish statutory rate on the payments made to the U.S. authors.

This article explains how a U.S. tax resident who receives foreign income – specifically income from Spain − can apply for a U.S. Certification on an early basis, prior to the beginning of a calendar year.

WHO IS ELIGIBLE FOR A U.S. TAX RESIDENCY CERTIFICATION?

In general, a U.S. Certification is issued only when the I.R.S. can verify that, for the year for which certification is requested, one of the following applies:

- The applicant filed an appropriate income tax return.
- If the return for the certification year is not yet due, the applicant filed a return for the most recent year for which a return was due.

The I.R.S. will deny a request for a U.S. Certification if the applicant is an individual taxpayer who

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[1] Under this test, the person qualifies as a U.S. resident if he/she is physically present in the U.S. for at least 31 days during the current year and at least 183 days during a three-year period, including the current year. The latter is determined on a weighted basis counting all of the days spent in the U.S. in the current year, 1/3 of the days of the previous year, and 1/6 of the days of the second preceding year. (Code §7701(b)(3)).

• did not file a U.S. income tax return (unless an exemption from filing applies[2]),

• filed a return as a nonresident, or

• is a dual resident and has made (or intends to make) an election under the so-called tie-breaker rule of an applicable income tax treaty to be treated not as a resident of the United States, but as a resident of the other foreign country.

"The U.S. Certification is one of the first, and most essential, documents a U.S. resident is required to obtain before he/she can avail the benefits of lower tax rates under the tax treaties."

WHAT TO FILE

An applicant seeking to obtain a U.S. Certification must apply by submitting the following documents to the I.R.S.:

• Form 8802, *Application for United States Residency Certification*

• A copy of the applicant's most recently filed U.S. income tax return

• An $85 user fee

A copy of the applicant's U.S. income tax return from the current or prior year is needed in order for the I.R.S. to verify that the applicant is in fact a U.S. tax resident during the year for which the U.S. Certification is requested.

If the applicant has filed or intends to file a Form 1116, *Foreign Tax Credit*, to claim either (i) a foreign tax credit amount in excess of U.S. $5,000 or (ii) a foreign tax credit for any amount of foreign earned income for the tax period for which certification is requested, evidence must be submitted to the I.R.S. to demonstrate that the applicant is a resident of the U.S. and the foreign taxes paid were not imposed because the applicant was a resident of the foreign country. If the tax return has been filed, a copy of the return together with a copy of Form 1116 and information with respect to income (*e.g.*, Form W-2 or Form 1099) must be attached to the application for the U.S. Certification.

For certain foreign countries, foreign claims forms exist, which may be attached to the application. This is, however, not the case for Spain.

The U.S. Competent Authority has agreed to provide the U.S. Certification in line with the language requested by Spain. The U.S. Certification will state, "I certify that, to the best of our knowledge, the above-named taxpayer is a resident of the United States within the meaning of the United States - Spain Income Tax convention."

WHEN TO FILE

The applicant should file the completed Form 8802 application and the $85 user fee at least 45 days before the date the applicant needs the U.S. Certification. Although as of June 2016 the applicant should have already filed a Form 8802 requesting a U.S. Certification for the year 2015, the applicant can still file the Form 8802 application for 2015 at this time. On that same Form 8802, the applicant can request a

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[2] An explanation of why the applicant was not required to file a U.S. income tax return needs to be attached to Form 6166.

Form 6166 U.S. Certification for the year 2016. Thus, the applicant can request on one Form 8802 that a U.S. Certification should be issued for the years 2016 and 2015, and any prior year.

However, the applicant must file a separate Form 8802 (and pay additional $85 user fee) for the year 2017. The earliest the applicant can file a Form 8802 request for a given year is on December 1 of the prior year. Thus, the earliest the applicant can file a Form 8802 request for the year 2017 is on December 1, 2016. The details are explained below for each tax year.

2015 AND 2016 TAX YEARS

As mentioned above, the applicant should have already filed the Form 8802 application for the 2015 tax year. However, the applicant can file the Form 8802 now to request a U.S. Certification be issued for the year 2015 (or any prior years), as well as 2016.

Line 7 of Form 8802

- Line 7 of Form 8802 should state "2015 and 2016" in order to request certifications for those years.
- If the applicant would like to request issuance of the U.S. Certification for years prior to 2015, include those prior years on Line 7.

Line 10 of Form 8802

- Line 10 of Form 8802 requires a penalty of perjury statement.
- If the applicant is requesting U.S. Certifications for 2015 (a prior year) and 2016 (the current year) on the same Form 8802 application, the penalty of perjury statement in Line 10 should be as follows: "[*Name of Individual and Taxpayer Identification Number*] was a U.S. resident for 2015 and will continue to be throughout the current tax year."

Lines 11 and 12 of Form 8802

- For providing the U.S. Certification to a withholding agent in Spain, Line 11 requires the applicant to state the number of U.S. Certifications requested in Column D to the right of "Spain" (referred to as Code "SP" on the form).

  A request for U.S. Certifications to be issued for the years 2015 and 2016 for Spain would require the applicant to enter the number "2" in Column D to the right of Spain in Line 11.
- The applicant may request that a U.S. Certification should be issued for other countries, as well, by following the above steps and stating the number of U.S. Certifications requested under the relevant column to the right of the relevant country.
- The total number of U.S. Certifications requested in all of columns A, B, C, and D of line 11 is shown on line 12.

Copy of U.S. Income Tax Return

- The Form 8802 application should include a copy of the individual's most recently filed U.S. income tax return.
- Special consideration should be given to the following circumstances:
  - If the applicant's 2015 U.S. tax return is (i) on extension or (ii) has not been filed, the Form 8802 application should include a signed copy of the individual's 2014 U.S. tax return.
  - If the applicant (i) recently filed a 2015 U.S. tax return or (ii) a 2015 tax return has not been posted by the I.R.S. by the time the Form 8802 is filed, the Form 8802 application should include a copy of the individual's 2015 U.S. tax return with the words "COPY – Do Not Process" on the return.

User Fee

- Each Form 8802 application must be filed with one non-refundable $85 user fee.
- The user fee is for the number of Form 8802 applications submitted and not the number of U.S. Certifications requested. Thus, an applicant may file one Form 8802 application and pay one $85 fee to request that a U.S. Certification should be issued for the current tax year, 2016, as well as any prior years.

2017 AND SUBSEQUENT TAX YEARS

The Form 8802 application for the year 2017 is completed in the manner explained above. However, certain differences exist.

Filing Date

- The earliest an applicant can file Form 8802 to request a U.S. Certification for the current year is on December 1 of the prior year. Applications filed before December 1 are not accepted by the I.R.S.
- To request a U.S. Certification for the year 2017, the earliest acceptable filing date is December 1, 2016.
  - A Form 8802 application for 2017 with a postmark date prior to December 1, 2016 will not be processed.
  - A Form 8802 application for 2017 with a postmark date on or after December 1, 2016 will be processed, provided the appropriate documentation is attached.
- As mentioned above, Form 8802 should be filed at least 45 days prior to the date the applicant needs the U.S. Certification.

> *"The earliest an applicant can file Form 8802 to request a U.S. Certification for the current year is on December 1 of the prior year. Applications filed before December 1 are not accepted by the I.R.S."*

Line 10 of Form 8802

- Line 10 of Form 8802 requires that the penalty of perjury statement must address the applicant's residency status in the prior year when the prior year return is not yet required to be filed.
- Thus, if the applicant files a 2017 Form 8802 before April 15, 2018 (*i.e.*, the due date for filing an individual income tax return for the year 2017, in the absence of an extension), line 10 should state, "[*Name of Individual and Taxpayer Identification Number*] was a U.S. resident for 2016 and will continue to be throughout the current tax year."

Copy of U.S. Income Tax Return

- The Form 8802 application for U.S. Certification for 2017 should include a copy of the individual's most recently filed U.S. income tax return.
- For the year 2017, the applicant should submit one of the following:
  - If the applicant files the Form 8802 on (i) the earliest date, *i.e.*, December 1, 2016, or (ii) before the 2016 U.S. tax return is filed, the applicant should include a copy of the 2015 U.S. tax return.
  - Otherwise, the applicant should include a copy of the 2016 U.S. tax return as indicated above.

User Fee

- The non-refundable $85 user fee is required for processing the Form 8802 request.
- This fee is subject to change and should be confirmed with the I.R.S. before submitting the application.

WHERE TO FILE

The method by which the applicant submits the Form 8802 application and supporting documents to the I.R.S. depends upon how the applicant chooses to pay the user fee. The user fee must be paid by check, money order, or electronic payment. The entire application and fee can be submitted by mail, private delivery service, or fax, as outlined below:

- Check or Money Order by Mail or Private Delivery
  - If the applicant is paying the user fee by check or money order, mail the (i) Form 8802 application, (ii) copy of the most recently filed U.S. tax return, and (iii) payment to the following address:

    Internal Revenue Service
    P.O. Box 71052
    Philadelphia, PA 19176-6052

- If the applicant is filing by private delivery service, the aforementioned documents should be sent to:

  Internal Revenue Service
  2970 Market Street
  BLN# 3-E08.123
  Philadelphia, PA 19104-5016

- Electronic Payment by Mail, Private Delivery, or Fax

  - If the applicant is paying the user fee by electronic payment, the electronic confirmation number must be included on page 1 of Form 8802.

  - The applicant can mail the Form 8802 application and copy of the most recently filed U.S. tax return to the following address:

    Department of the Treasury
    Internal Revenue Service
    Philadelphia, PA 19255-0625

  - Or, these documents can be sent by private delivery service to:

    Internal Revenue Service
    2970 Market Street
    BLN# 3-E08.123
    Philadelphia, PA 19104-5016

  - The applicant can fax up to ten Forms 8802 (including all required attachments), for a maximum of 50 pages, to the fax numbers below. A fax cover sheet stating the number of pages included in the transmission must be used. The following fax numbers are not toll free:

    (267) 941-1035 or (267) 941-1366

"Without the U.S. Certification in place at the beginning of the year, a Spanish payor is required to withhold tax at the statutory rate."

All foregoing addresses and fax numbers are subject to change and should be confirmed prior to the submission.

CONCLUSION

The U.S. Certification is the most essential document a U.S. tax resident obtains in order to enjoy the benefits of an income tax treaty – reduced tax rates or complete exemption from foreign tax on foreign income. Without the U.S. Certification in place at the beginning of the year, a Spanish payor is required to withhold tax at the statutory rate. It is highly recommended that a U.S. resident submits a request for the U.S. Certification on or immediately after December 1, 2016 for a 2017 certification.

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Tags
Corporate Law
Earnout
Sale

CORPORATE MATTERS:
EARNOUTS

Typically, when a client is involved in an acquisition, the purchase price is paid in cash, stock of the buyer, a promissory note, or a combination thereof. Factors that lead to one form of payment being used over another include (i) the seller's willingness to be involved in the business post-closing, (ii) the buyer's ability to fund an all-cash purchase, (iii) the various tax implications, and (iv) the type of transaction – all stock, asset acquisition, or merger. In addition, determining the amount of the purchase price can be a complex process and a wide gulf may exist between the views of the buyer and those of the seller. The gulf is often bridged through the adoption of an earnout clause in the contract. This article provides an introduction to earnout clauses and their application.

WHAT IS AN EARNOUT?

An earnout provision in a contract makes a portion of the purchase price contingent upon the target company achieving certain milestones during a period of time following the closing. The milestones are commonly based on financial benchmarks, which often include revenue, net income, or E.B.I.T.D.A. (earnings before interest, taxes, depreciation, and amortization) targets. Non-financial benchmarks, such as the number of contracted sales or improvement of manufacturing efficiencies, can be appropriate with respect to some businesses.

An earnout is not a purchase price adjustment. A purchase price adjustment is used where there is a fundamental agreement as to the purchase price but a long period of time between that agreement and the closing of the acquisition. The adjustment is to reflect changes in the value of the target from the date of signing an acquisition agreement to the date of the closing.

WHEN ARE EARNOUTS USED?

An earnout is used when the seller and buyer cannot agree on the purchase price, such as in the case of a disagreement about the expected growth and future performance of the target entity, or when the buyer is unable to pay the full purchase price at closing. In the former situation, the seller has often built the business over a number of years and believes that it is well-positioned for future sales growth, while the buyer is typically less optimistic. When disagreements arise over projected earnings or other indicia of value, earnouts can be useful. Earnouts are also useful when a buyer is buying a business which has earnings that are generated by a new product and whose valuations are based on projected sales that are based on limited experience. An earnout may also be appropriate if the seller is going to continue in a management role after closing or if the target will continue to operate as a stand-alone business.

An earnout may make the seller as interested in the identity of the buyer as with the amount of money offered for the purchase. The seller will want the buyer to be capable of running the business in a way that ensures that the agreed-upon milestones are reached and payments made promptly thereafter. The buyer's track record with other sellers will also be important. If the seller is reluctant to agree to an earnout, the buyer will want to demonstrate that he or she is up to the task of running the business and that the seller should accept a lower amount at closing, with the expectation of perhaps achieving a higher purchase price over time, in order to make the sale happen.

EARNOUT TERM

It is important that the earnout term not be too long. Typically, the buyer's exercise of discretion in integrating the target business is limited, as the seller correctly wants wide latitude in making business decisions. The seller also has an interest in limiting intercompany charges from the acquiring group. An earnout term is fixed, and a period of one, two, or three years is common. Anything longer puts a chill on the buyer's ability to run the business as it sees fit. A period longer than three years also potentially exposes the seller to greater risk, as external factors not existing at the time of sale – a general economic downturn, for example – may impact the buyer's ability to reach long-term milestones. In comparison, the buyer is interested in integrating the business in order to realize the benefits of the acquisition.

FINANCIAL METRICS

Earnout payments are predicated upon the achievement of certain milestones over a fixed period after closing. If a milestone is achieved, the seller is entitled to either a fixed or computed payment. Sellers typically propose milestones related to a higher level of financial reporting, such as sales or gross income, which are less affected by the buyer's operational decisions. They buyer, on the other hand, will often argue for milestones based on a number from which all expenses of the business have been deducted. Use of E.B.I.T.D.A. for the financial target is a common compromise in an earnout.

Non-financial milestones that are important to the parties, such as product approval by a regulatory body, may also be used.

DISPUTES

Where there is a fundamental dispute as to the purchase price prior to closing, that disagreement often carries over into the post-closing period. In difficult circumstances, such disputes may eventually manifest themselves in the form of litigation. Courts have observed that "[e]arnouts all too often transform current disagreements over price into future litigation over outcome."[1]

From the seller's point of view, disputes often arise with respect to the operation of the business by the buyer post-closing. In cases where the seller has less leverage, the buyer operates the business without input from the seller and this can lead to

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1 *Airborne Health, Inc. v. Squid Shop*, LP, 984 A.2d 126 (Del. Ch. 2009).

allegations that the business is being intentionally operated in a way to minimize earnout payments. Earnout provisions in an acquisition agreement will generally attempt to address this issue by including language with respect to the continued operation of the business, but these clauses are difficult to nail down and hard to enforce. Sellers and buyers can look at the same set of facts regarding continuation of the business and reach opposing conclusions.

To overcome these types of disputes, it is sometimes agreed that the seller will stay on in the business as an advisor or even continue to run the business during a transitional period. This too, though, may lead to a dispute, as the buyer may allege that the business is being managed in such a way as to increase short-term gain while harming the company long term.

CONCLUSION

Earnout provisions can be a useful way to prevent a deal from falling through when the parties genuinely cannot agree on price. Their main utility is in cases where a seller has encountered difficulty in finding an acceptable buyer and the acceptable company cannot come up with the total purchase price. Otherwise, earnouts often lead to disputes. Nonetheless, when properly drafted in the right set of circumstances, some sellers have been very happy with the results.

"An earnout may make the seller as interested in the identity of the buyer as with the amount of money offered for the purchase."

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Tags
Action 5
Action 13
Action 14
B.E.P.S.
Beneficial Owner
CbC Reporting
Covered Financial Institution
K.Y.C.

CANADIAN TAX AGENCY IDENTIFIES RULINGS FOR B.E.P.S. EXCHANGES

The Canadian Revenue Agency ("C.R.A.") has categorized several advance pricing arrangements and income tax rulings as information to be exchanged with other jurisdictions in compliance with B.E.P.S. Action 5.[1]

Action Item 5 generally recommends the compulsory spontaneous exchange of information with regard to tax rulings related to preferential tax regimes. A previous edition of *Insights* discussed Action Item 5, noting that:

> [Action Item 5] will introduce an obligation for an individual country to spontaneously exchange information that could be relevant to another country, even when the information has not been requested by the second country. In addition, the Forum on Harmful Tax Practice is authorized to prepare a report on preferential regimes for public dissemination – *viz.*, name and shame.[2]

The following material will be subject to an information exchange by the C.R.A.:

- Cross-border rulings related to preferential taxation regimes, which in Canada include international shipping and some foreign life insurance operations of Canadian entities
- Cross-border rulings related to legislation governing transfer pricing
- Cross-border rulings that provide a downward adjustment that is not reflected in the taxpayer's account
- Rulings on permanent establishment ("P.E.") issues
- Rulings on related-party conduits

The C.R.A. will share this information with the immediate parent's resident country, the ultimate parent's resident country, and "certain other parties." Additional information must be requested from the C.R.A.'s Authority Service Division in accordance with Canadian law.

In light of the Panama Papers revelations, multinational companies ("M.N.C.'s")

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1 Canadian Revenue Agency, "Advance Income Tax Rulings and Technical Interpretations," No. IC70-6R7.

2 Stanley C. Ruchelman and Rusudan Shervashidze, "Action Item 5: Countering Harmful Tax Practices More Effectively," *Insights* 1, no. 9 (2014).

remain vigilant about privacy issues and public opinion. While the Canadian government will only release information pursuant to Canadian law, the law may be altered by a Parliamentary Act. Further, bilateral procedures and subjective processes, such as the differing country-by-country ("CbC") report submission dates, seem to undermine the B.E.P.S. Project's goal of creating a universal, streamlined compliance standard. The B.E.P.S. action items continue to be implemented piecemeal, and questions remain as to whether implementation will actually exacerbate the problem that the B.E.P.S. Project was created to solve: the prevalence of schemes whose principal purpose is the avoidance or evasion of taxes via a disjuncture of rules in two or more countries.

I.R.S. WORKING TO ACCEPT EARLY CBC REPORTS

The I.R.S. previously required that M.N.C.'s submit their CbC reporting to the U.S. by July 1, 2016. However, several other countries required CbC submissions before that date, resulting in an overlap of compliance for M.N.C.'s. The U.S. is attempting to resolve the problem by accepting voluntary CbC reports before its original July 1, 2016 deadline.

Documentation Requirements

In an article previously published in *Insights* which discussed CbC reporting, the following was stated:

Action Item 13 calls for a revamp of transfer pricing documentation. The new guidance calls for a three-tiered approach to global transfer pricing documentation, including:

> 1. A Master File – a high-level overview of the multinational group business;
>
> 2. A Local File – detailed information on specific group transactions for a given country; and
>
> 3. A Country-by-Country ("CbC") report – a matrix of specific data for each jurisdiction, ostensibly to be used as a risk assessment tool by tax authorities (as well as, potentially, taxpayers).[3]

Submissions to Foreign Jurisdictions

Some U.S. corporations are contemplating creating a surrogate foreign parent or submitting CbC reports directly to foreign jurisdictions. M.N.C.'s are concerned that governments may divulge information to the media for partisan political purposes and that the modified CbC submission process will preclude the goal, envisioned in B.E.P.S. Action 13, of creating one universal form.[4] In an attempt to streamline

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3 Sherif Assef, "Action Item 13: Guidance On Transfer Pricing Documentation and County-By-Country Reporting," *Insights* Special Edition: B.E.P.S. Retrospective (2014).

4 Michael Peggs, "Country-by-County Reporting: Where Are We Going?," *Insights* 4 (2016).

the reporting process, the I.R.S. is negotiating with foreign jurisdictions to accept voluntary CbC reports from U.S. entities.

B.E.P.S. PROCESS FUELING "GROWTH BUSINESS" FOR MUTUAL AGREEMENT PROCEDURES

Tax practitioners fear that the B.E.P.S. Mutual Agreement Procedure ("M.A.P.") will expand, rather than settle, inter-country disputes, as resolution procedures depend on subjective tests. In an article previously published in *Insights*, which discussed the M.A.P., the following was stated:

> The goal is to provide an objective M.A.P. process that addresses issues in a fair manner based on the rule of law rather than selfish interests. Whether Action 14 will succeed is an open question. In comparison to the other components of the B.E.P.S. Action Plan, the targets of Action 14 are the authorities that set the rules. It is not clear that these officials will have the political commitment to promote fairness over collection of tax revenue.[5]

Additionally, last month's edition of *Insights* addressed the possibility that the B.E.P.S. Project may result in M.N.C.'s hiring full-time compliance officers to oversee cross-border operations. In fact, the I.R.S. itself now intends to employ full-time compliance officers to police B.E.P.S.

M.N.C.'s are anxious as to whether the resources exist to resolve M.A.P. issues within 24 months of binding arbitration. The I.R.S. remains convinced that binding arbitration and M.A.P.S. will incentivize taxpayers to resolve disputes. The question that persists is whether taxpayers will resolve B.E.P.S. matters under the belief that the I.R.S. is "correct," or whether disputes will be resolved solely to avoid costly B.E.P.S.-related litigation.

NEW RULE FORCES FINANCIAL INSTITUTIONS TO TRACK "BENEFICIAL OWNERS" OF CERTAIN FOREIGN ENTITIES

New Regulations

Last week, the I.R.S. published a final rule regarding financial institutions and the identification of their clients. The rule requires a covered financial institution ("C.F.I.") to identify clients that are "beneficial owners" of certain entities.[6] C.F.I.'s include banks, brokers, dealers, mutual funds, commission merchants, and commodity brokers. Client information will be required whenever companies incorporate or

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5 Stanley C. Ruchelman and Sheryl Shah, "Action Item 14: Make Dispute Resolution Mechanisms More Effective," *Insights* Special Edition: B.E.P.S. Retrospective (2014).

6 "Customer Due Diligence Requirements for Financial Institutions," Department of the Treasury (May 2, 2016).

transfer ownership of a C.F.I. into the U.S. Compliance will not be mandatory until May 18, 2018.

C.F.I.'s must verify the identification of a "beneficial owner" of an entity when an account is opened. A "beneficial owner" is an individual who owns more than 25% of the equity interests in the entity, or a single individual who exercises control over the entity. The entity must also identify a "senior manager" that the I.R.S. can contact with inquiries.

"In the future, the I.R.S. could force compliance by refusing to issue an employer identification number ('E.I.N.') to any entity that did not disclose its information on an E.I.N. application."

Entities affected by the new rule include corporations, partnerships, limited liability corporations, general partnerships, and any similar foreign entity that opens an account. Practitioners should note that certain entities are excluded from this list, including trusts, sole proprietorships, and unincorporated associations.

Practically, C.F.I.'s will rely on the information provided by their clients and are not required to confirm this information, unless the C.F.I. has knowledge that the submitted information is fraudulent. C.F.I.'s must also update their records if changes are discovered during routine reviews. The information is to be entered into a database. Records must be kept for five years after an account is closed.

Criticism

Evasive clients may still provide financial institutions with falsified documents, allowing the institution to comply with the rule but thwarting the I.R.S.' attempts to uncover the identity of the "true" owner. Entities may also list an individual as a "senior manager" even though even though he or she would have no real responsibilities, thereby hindering I.R.S. investigations.

The entity could also restrict individual ownership interests below 25% to evade the new rule. Industry groups note that the information received from clients may range from fully transparent to opaque, with the C.F.I. bearing responsibility for determining the truth. Finally, multinational entities may require additional personnel to track various internal ownership changes that take place within a consolidated group.

In the future, the I.R.S. could force compliance by refusing to issue an employer identification number ("E.I.N.") to any entity that did not disclose its information on an E.I.N. application, since an E.I.N. is generally required to open a bank account within the U.S.

UPDATES & OTHER TIDBITS

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Tags
Cash Pooling
Code §385
Earnings Stripping
Foreign Ownership
Hiring
L.L.C.
Tax Evasion

"CASH POOLING" UNDER ATTACK AS PART OF EARNINGS-STRIPPING RULES

Cash pooling involves a special structure, known as a "treasury center," which is used by companies that are members of a multinational group of companies to pool excess cash in one bank, so that it can be made available to other group members in need of short-term liquidity. The cash pooling system provides subsidiaries with easy access to internal funding without the problems and expense of going to outside banks. In general, cash pooling arrangements are meant to provide short-term loans. These typical cash management strategies are now under attack.

On April 4, 2016, the Treasury Department issued proposed regulations under Internal Revenue Code ("Code") §385,[1] known as the "earnings-stripping" rules, intended to limit companies from shifting or "stripping" income outside the United States through loans made to subsidiaries. The proposed regulations would characterize as equity a broad range of debt between related parties, including (i)_ notes distributed to a related shareholder, (ii) notes issued to acquire equity of a related entity, and (iii) notes distributed to a related entity in an asset reorganization. In order to support the treatment of an instrument as debt, taxpayers would be required to provide contemporaneous documentation, describing the commercial terms of the lending and providing an analysis of the creditworthiness of the borrower. If the documentation is not provided within 30 days, the financing would generally be characterized as equity.[2]

Practitioners have reacted to the earnings-stripping rules' long reach by stressing to the Treasury Department that cash pooling is not any kind of tax planning, but a routine and practical way of doing business for large multinationals. Many have recently urged for a cash pooling carve-out in the proposed regulations. It remains to be seen what the Treasury Department will do when the proposed regulations move into the finalization stage.

TREASURY ANNOUNCES ACTIONS TO STRENGTHEN FINANCIAL TRANSPARENCY

Though many countries are adopting tougher measures to combat tax evasion and money-laundering, some observers have stated that the U.S. tax and legal systems

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1 REG-108060-15.

2 See Philip R. Hirschfeld's article "Related-Party Debt: Proposed Code §385 Regulations Raise Major New Hurdles," in this month's edition of *Insights*, for an expanded discussion of the new proposed rules.

provide foreigners with opportunities to legally hide income from their governments.

In a recent public statement, Treasury Secretary Jacob J. Lew announced several actions to strengthen financial transparency and combat the misuse of companies to engage in illicit activities, namely (i) a customer due diligence ("C.D.D.") Final Rule, (ii) proposed beneficial ownership legislation, and (iii) proposed regulations related to foreign owned, single-member limited liability companies ("L.L.C.'s").[3]

The C.D.D. Final Rule, issued by the Financial Crimes Enforcement Network ("FinCEN") under the Bank Secrecy Act, adds a new requirement for financial institutions, such as banks, brokers or dealers in securities, and mutual funds, to collect and verify the personal information of the real people (*i.e.*, the beneficial owners) who own, control, and profit from companies when those companies open accounts. Further, under the final rule, financial institutions will have to identify and verify the identity of any individual who owns 25% or more of a legal entity, and any individual who controls a legal entity.

The beneficial ownership legislation sent to Congress by the Obama Administration would require companies to know and report adequate and accurate beneficial ownership information at the time of a company's creation, so that the information can be made available to law enforcement. Companies formed in the U.S. would be required to file beneficial ownership information with the Treasury Department or face penalties.

The Treasury Department published proposed regulations on May 10, 2016. Among other things, unless certain exceptions apply, foreign owned, single-member L.L.C.'s would be required to to obtain an employer identification number from the Internal Revenue Service (the "I.R.S.") and to file information returns reporting transactions between the L.L.C. and its foreign parent. These regulations are aimed at a narrow class of U.S. entities – usually foreign owned, single-member L.L.C.'s – that have no obligation to report information to the I.R.S. but may be used to shield foreign owners of non-U.S. assets and non-U.S. bank accounts. The Treasury secretary stated that, "once the regulations are finalized, they will allow the I.R.S. to determine whether there is any tax liability, and if so, how much, and to share the information with other tax authorities."

I.R.S. COMMISSIONER KOSKINEN ANNOUNCES NEW HIRING IN ENFORCEMENT AREAS

The operating budget of the I.R.S. has decreased by more than $900 million since 2010. The constrained budget has led to a significant decline in the number of employees. Earlier this year, the I.R.S. received $290 million from Congress for hiring 1,000 employees for its taxpayer telephone assistance service and adding reinforcement in the areas of taxpayer services, identity theft, and cybersecurity.

In early May, Commissioner Koskinen announced that the I.R.S. had enough resources to hire between 600 and 700 new employees in the enforcement areas. The primary motivation for the increase in hiring resources is the large number of

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[3] Department of the Treasury, "Treasury Announces Key Regulations and Legislation to Counter Money Laundering and Corruption, Combat Tax Evasion," press release, May 5, 2016.

retirees and high overall attrition rate among enforcement employees. This new hiring opportunity will mark the first significant hiring of enforcement personnel in more than five years.

Koskinen stated that there will be two waves of job announcements. The first wave will begin in the next few weeks, with announcements being posted internally and externally for many entry-level positions. First-wave hiring will include revenue agents, revenue officers, and other enforcement positions, primarily in the Small Business/Self-Employed Division. The second wave of hiring is expected to come later this year, providing employees with promotional opportunities for higher-level enforcement positions, including in the Large Business & International, Small Business/Self-Employed and Tax-Exempt/Government Entities divisions, as well as positions in Appeals. Employees in the second wave of hiring will assist with high-profile enforcement areas, including international tax issues.

"The addition of 600 to 700 employees in 2016 should be viewed not as an increase in hiring but simply as a decrease in attrition."

Despite the anticipated increase in hiring, Koskinen stated that, by the end of 2016, the I.R.S. will still be down more than 2,000 employees for the year, bringing the total loss of employees to over 17,000 since 2010. More than 5,000 of those lost employees have been in the enforcement areas. Thus, the addition of 600 to 700 employees in 2016 should be viewed not as an increase in hiring but simply as a decrease in attrition.

About Us

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

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

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

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

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