International Tax Impact of Business Entity Selection for Foreign Operations of U.S. Companies

TUESDAY, DECEMBER 12, 2017, 1:00-2:50 pm Eastern

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International Tax Impact of Business Entity Selection

Dec. 12, 2017

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International Tax Impact of Business Entity Selection for Foreign Operations of U.S. Companies

Lori Hellkamp, Jones Day
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December 12, 2017
Choice of Entity Options

• US taxpayer engaging in business abroad:
  1. Legal entity disregarded for U.S. tax purposes
  2. Branch (direct investment without local legal entity)
  3. Partnership
  4. Corporation

• Both tax and non-tax factors drive entity selection

• Tax classifications are independent of local (non-tax) law categories.
  • This can include whether an entity is deemed to exist.
## Choice of Entity: Key Considerations

<table>
<thead>
<tr>
<th></th>
<th>Disregarded Entity / Branch</th>
<th>Partnership</th>
<th>Corporation</th>
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<tbody>
<tr>
<td>US investor annually taxable in US on foreign income?</td>
<td>Yes</td>
<td>Yes</td>
<td>No* (exceptions for CFCs &amp; certain PFICs)</td>
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<tr>
<td>US investor subject to US tax on distributions?</td>
<td>No</td>
<td>No, with exceptions</td>
<td>Yes* (although reduced for certain previously taxed amounts, as applicable)</td>
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<tr>
<td>Foreign losses can offset US investor’s US income tax?</td>
<td>Yes</td>
<td>Yes, but limited</td>
<td>No</td>
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*Expected to change under US tax reform, discussed later
Foreign Legal Entities

Per Se Corporations

• Certain entities will be treated as corporations for US tax purposes.

• § 301.7701-2(b) provides that for Federal tax purposes, the term “corporation” means:

  • Certain business entities: “incorporated”, “corporation”, “body corporate”, “body politic”, “joint-stock company” or “joint-stock association”
  • An insurance company
  • Certain banking entities
  • A business entity wholly owned by a state, political subdivision, foreign government or any other entity described in § 1.892-2T
  • A business entity taxable as a corporation under some provision of the Code other than § 7701(a)(3)
  • Specific types of foreign entities listed in § 301.7701-2(b)(8)
Foreign Legal Entities

Eligible Entities

• Business entities not required to be treated as corporations are “eligible entities”
• By default (if no election is filed), a foreign eligible entity is generally:
  • **Corporation** if each owner has limited liability
  • **Partnership** if 2 or more owners, and at least 1 does not have limited liability
• Limited liability (i.e., no personal liability for the entity’s debts) is determined under applicable local law
• Single-owner eligible entities can elect to be treated as a disregarded entity for US purposes
• Multiple-owner eligible entities can elect to be classified as a corporation or a partnership, as relevant
• Change of entity classification election is filed on Form 8832
Disregarded entity

- Tax items (income, loss, deductions) are taken into account in the first instance by the U.S. taxpayer.
- Hybrid entity – A disregarded entity for U.S. tax purposes may not be tax transparent under local law.
- Income of a disregarded entity is generally subject to both foreign and U.S. tax.
- Foreign income taxes generally give rise to a foreign tax credit for US purposes to avoid double tax on the same income.
- US owners of foreign disregarded entities must file Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities.
Foreign branch

- Generally, for US tax purposes, same as a disregarded entity.
- If the foreign jurisdiction is one with which the U.S. has a tax treaty, the foreign jurisdiction may not impose tax on the foreign branch’s income if the branch is not a “permanent establishment.”
- Special recapture and other rules may apply if the foreign branch is subsequently incorporated, especially if the branch had generated losses. Tax reform proposes to introduce additional branch loss recapture rules.
Key US Tax Aspects

Foreign corporation

- Foreign corporations are separate taxable entities.
- Income of a foreign corporation is generally not subject to U.S. tax until repatriated (e.g., by dividend, investment in U.S. property, or loan to U.S. parent). *This is expected to change under US tax reform.*
- Current income inclusions may apply however when the foreign corporation is a CFC or, in some cases, a PFIC.
  - CFC – foreign corporation more than 50% owned by 10% US shareholders
  - PFIC – foreign corporation with material passive assets or income
- U.S. persons that own a foreign corporation may need to file Form 5471.
Key US Tax Aspects

Foreign corporation

Subpart F

• If the entity is a controlled foreign corporation ("CFC"), Subpart F income is currently taxable to U.S. shareholders at the end of the year pro rata.
  • Subpart F income is defined in § 952.
• A CFC is a foreign corporation more than 50% owned by U.S. shareholders.
  • U.S. shareholders are U.S. persons who own at least 10%
• Foreign income previously included in a U.S. shareholder’s income by operation of these rules is generally excluded from such shareholder’s income upon subsequent distribution to the shareholder.
• If a US shareholder sells stock in a CFC, some portion of the gain may be re-characterized as a deemed dividend from the CFC to the seller.
• Pending tax reform is expected to modify the application and importance of some of these rules, especially for US shareholders that are corporations.
Foreign partnership

• Like corporations, partnerships are separate entities.
• Unlike corporations, the tax items of a foreign partnership flow through to partners on a current basis. A U.S. partner must take its distributive share of partnership tax items into account annually.
• Unlike corporations, when a partner receives an actual distribution from its partnership, the amount generally is not taxable by the U.S.
• U.S. persons who do business abroad via partnerships may need to file Form 8865.
Limiting investor’s legal exposure is often a critical, non-tax factor.
Local law may vary significantly with respect to limitation of liability, compliance requirements, permissible debt/equity funding and exiting the investment based on entity type.
Local tax law considerations can also vary depending on entity selection.
If business operations are undertaken in conjunction with other actors (e.g., joint venture partners), the specifics of the arrangement may drive entity choice.
The presence (or absence) of U.S. tax and other treaties may make one type of entity preferable to others.
“Check the Box” Elections

- Entity classification may be changed by filing a Form 8832.
- Once made, the election is treated as effective as of the date specified on the Form 8832, or if none is specified, then as of the date the election is filed.
- Election can be made effective up to 75 days retroactively, or 12 months prospectively from the date of filing.
- Once made, an election generally may not be changed for 60 months.
  - Exception if permission obtained from the IRS because more than 50% of the ownership changed since the filing date or effective date of the election
  - Exception for initial election
Classification Change

• If an existing entity elects to change its classification, certain events are generally deemed to occur for US tax purposes:

  • **Partnership -> corporation**: the partnership contributes its assets and liabilities to a new corporation in exchange for stock of the corporation, then the partnership liquidates distributing the corporation’s stock to its partners
  • **Corporation -> partnership**: the corporation liquidates, distributing all assets and liabilities to its shareholders, then the shareholders contribute those assets and liabilities to a new partnership
  • **Corporation -> disregarded entity**: the corporation liquidates, distributing all assets and liabilities to its sole shareholder
  • **Disregarded entity -> corporation**: the owner of the entity contributes all of its assets and liabilities to a new corporation in exchange for stock of the corporation

Some of these transactions pose the possibility of gain recognition, which should be considered before filing an election to change the entity’s U.S. tax classification.
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for Foreign Operations of U.S. Companies

Alison N. Dougherty       December 12, 2017


http://blogs.aronsonllc.com/tax/reporting-foreign-accounts-offshore-assets/
http://blogs.aronsonllc.com/tax/what-should-i-do-if-i-did-not-report

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International Tax Impact of Business Entity Selection for Foreign Operations of U.S. Companies

- U.S. company structure
  1. C corporation
  2. S corporation
  3. Partnership including multi-member U.S. LLC
  4. Single member wholly-owned U.S. LLC

- Foreign company structure
  1. Foreign corporation (C corporation)
  2. Foreign partnership
  3. Foreign disregarded entity
  4. Foreign branch
U.S. Federal Check-the-Box Entity Classification

Basic Terminology

- **Limited liability** - U.S. Treas. Reg. § 301.7701-3(b)(2)(ii)
  1. An owner does not have personal liability for any debts or claims against the entity
  2. Determination is based on the law under which the entity is organized and the organizational documents
  3. An owner has personal liability if the creditors of the entity can satisfy all or part of the debts or claims against the entity from the owner
  4. An owner has personal liability even if the owner makes an agreement where any person assumes the liability or agrees to indemnify the owner for the liability
U.S. Federal Check-the-Box Entity Classification

Basic Terminology

- **Foreign corporation**
  1. Listed - foreign entity on the per se foreign corporation list
  2. By default - All owners of the foreign entity have limited liability
  3. By election – all owners of a foreign eligible entity do not have limited liability

- **Foreign partnership**
  1. By default – more than one owner of foreign entity and at least one owner does not have limited liability
  2. By election – more than one owner of foreign eligible entity and all owners have limited liability
U.S. Federal Check-the-Box Entity Classification
Basic Terminology

- Foreign disregarded entity
  1. By default – foreign entity with one owner that does not have limited liability that is treated as an entity not separate from its single owner for U.S. Federal income tax purposes
  2. By election – foreign eligible entity with a single owner that does have limited liability that elects to be classified as an entity not separate from its single owner for U.S. Federal income tax purposes
U.S. Federal Check-the-Box Entity Classification

Basic Rules

- **Foreign eligible entity**
  1. foreign entity not included on the per se foreign corporation list
  2. Foreign entity that is a foreign corporation per default rule

- **Foreign entity default rule** - Classification unless election filed
  U.S. Treas. Reg. § 301.7701-3(b)(2)(i)
  1. A partnership if it has two or more members and at least one member does not have limited liability.
  2. An association taxable as a corporation if all members have limited liability.
  3. Disregarded as an entity separate from its owner if it has a single owner that does not have limited liability.
U.S. Tax Advantages and Pitfalls with Income and Losses from Different Structures – Foreign Corporation

- Foreign corporation
  1. Not controlled by U.S. persons – Tax advantage of deferral
  2. Controlled by U.S. persons (CFC) – Limited deferral per Subpart F
  3. 10% C corporation shareholder may claim indirect foreign tax credit when dividends repatriated or Subpart F income inclusion
  4. U.S. shareholders cannot claim losses
  5. Form 5471 filing requirement in some circumstances
U.S. Tax Advantages and Pitfalls with Income and Losses from Different Structures – Foreign Partnership

- Foreign partnership
  1. No deferral
  2. Current year inclusion of U.S. partner’s distributive share of income, gain, loss, deduction, and credit from foreign partnership on U.S. partner’s U.S. tax return
  3. Foreign income taxes paid by foreign partnership pass through and are creditable to U.S. partner against U.S. tax on foreign source taxable income but subject to limitation
  4. U.S. partner deducts foreign partnership losses only to the extent of basis, at risk, and passive activity loss rules
  5. Form 8865 filing requirement in some circumstances
U.S. Tax Advantages and Pitfalls with Income and Losses from Different Structures – Foreign Disregarded Entity or Branch

- **Foreign Disregarded Entity**
  1. No deferral
  2. Current year inclusion of 100% of FDE’s income and loss on U.S. owner’s U.S. tax return
  3. Foreign income taxes paid by the FDE pass through and are creditable to U.S. owner against U.S. tax on FDE’s foreign source taxable income
  4. Form 8858 filing requirement

- **Foreign Branch**
  1. No deferral
  2. Current year inclusion of 100% of branch income and loss on U.S. company’s tax return
  3. Foreign income taxes paid on branch activity are creditable to U.S. company against U.S. tax on foreign source branch taxable income
Form 8832 Check-the-Box Entity Classification Election
Page One

<table>
<thead>
<tr>
<th>Form 8832</th>
<th>Entity Classification Election</th>
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Information about Form 8832 and its instructions is at www.irs.gov/form8832.

**Part I: Election Information**

1. **Type of election** (see instructions):
   a. Initial classification by a newly-formed entity. Skip lines 2a and 2b and go to line 3.
   b. Change in current classification. Go to line 2a.

2a. Has the eligible entity previously filed an entity election that had an effective date within the last 60 months?
   - Yes. Go to line 2b.
   - No. Skip line 2b and go to line 3.

2b. Was the eligible entity’s prior election an initial classification election by a newly formed entity that was effective on the date of formation?
   - Yes. Go to line 3.
   - No. Stop here. You generally are not currently eligible to make the election (see instructions).

3. Does the eligible entity have more than one owner?
   - Yes. You can elect to be classified as a partnership or an association taxable as a corporation. Skip line 4 and go to line 5.
   - No. You can elect to be classified as an association taxable as a corporation or to be disregarded as a separate entity. Go to line 4.

4. If the eligible entity has only one owner, provide the following information:
   a. Name of owner
   b. Identifying number of owner

5. If the eligible entity is owned by one or more affiliated corporations that file a consolidated return, provide the name and employer identification number of the parent corporation:
   a. Name of parent corporation
   b. Employer identification number

For Paperwork Reduction Act Notice, see instructions.
Form 8832 Check-the-Box Entity Classification Election

Page Two

Part I Election Information (Continued)

6 Type of entity (see instructions):
   a [ ] A domestic eligible entity electing to be classified as an association taxable as a corporation.
   b [ ] A domestic eligible entity electing to be classified as a partnership.
   c [ ] A domestic eligible entity with a single owner electing to be disregarded as a separate entity.
   d [ ] A foreign eligible entity electing to be classified as an association taxable as a corporation.
   e [ ] A foreign eligible entity electing to be classified as a partnership.
   f [ ] A foreign eligible entity with a single owner electing to be disregarded as a separate entity.

7 If the eligible entity is created or organized in a foreign jurisdiction, provide the foreign country of organization [ ].

8 Election is to be effective beginning (month, day, year) (see instructions) [ ].

9 Name and title of contact person whom the IRS may call for more information

10 Contact person’s telephone number

Consent Statement and Signature(s) (see instructions)

Under penalties of perjury, I (we) declare that I (we) consent to the election of the above-named entity to be classified as indicated above, and that I (we) have examined this election and consent statement, and to the best of my (our) knowledge and belief, this election and consent statement are true, correct, and complete. If I am an officer, manager, or member signing for the entity, I further declare under penalties of perjury that I am authorized to make the election on its behalf.

Signature(s) | Date | Title
---|---|---


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Form 8832 Check-the-Box Entity Classification Election

Page Three

### Part II Late Election Relief

11. Provide the explanation as to why the entity classification election was not filed on time (see instructions).

Under penalties of perjury, I (we) declare that I (we) have examined this election, including accompanying documents, and, to the best of my (our) knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete. I (we) further declare that I (we) have personal knowledge of the facts and circumstances related to the election. I (we) further declare that the elements required for relief in Section 4.01 of Revenue Procedure 2009-41 have been satisfied.

<table>
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<th>Signature(s)</th>
<th>Date</th>
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Form 8832 Check-the-Box Election

Who must file?

- A foreign eligible entity that has more than one owner, all owners having limited liability, electing to be classified as a foreign partnership.

- A foreign eligible entity that has at least one owner that does not have limited liability, electing to be classified as an association taxable as a foreign corporation.

- A foreign eligible entity with a single owner having limited liability, electing to be a foreign entity disregarded as an entity separate from its owner.

- A foreign eligible entity electing to change its current classification (even if it is currently classified under the default rule).
Form 8832 Check-the-Box Election

When to file?

- Timely filed election – Effective date is not retroactive more than 75 days prior the date when the election is filed
- Prospective election – Effective date is not more than 12 months after the date when the election is filed
- 60-month limitation rule – Election cannot be changed within 60 months of the effective date of a prior election. This rule does not apply if the prior election was made by a newly formed eligible entity and was effective on the date of formation.
- Late election relief
Form 8832 Check-the-Box Election
Late Election Relief

Rev. Proc. 2009-41, Section 4.01 late election requirements

- The entity did not obtain the requested classification as of formation date or when it became relevant or it did not obtain change in classification solely because Form 8832 was not filed.

- The entity (or affected person) has not filed a U.S. Federal tax or information return for the first year of election because the due date has not passed, OR

- The entity (or affected person) has timely filed all required U.S. Federal tax returns and information returns (or if not timely filed within 6 months of the original due date) consistent with the election for all years for which the election is to be effective and no inconsistent tax or information returns have been filed during any of the tax years.

- The entity has reasonable cause for its failure to timely file the election.

- Three years and 75 days from the requested effective date of the election have not passed.
Form 8832 Check-the-Box Election
I.R.C. Section 9100 Late Election Relief

- U.S. Treas. Reg. § 301.9100-3 allows Form 8832 check-the-box late election relief by filing a Private Letter Ruling request with the IRS.
- See Rev. Proc. 2016-1, Section 5.03(5) and (6).
- U.S. Treas. Reg. § 301.9100-3 late election relief by PLR is available if the requirements of Section 4.01 of Rev. Proc. 2009-41 are not satisfied.
- As a condition, must be able to make the following statement in the PLR request per Rev. Proc. 2016-1, Section 5.03(6).

All required U.S. tax and information returns of the entity (or, if the entity was not required to file any such returns under the desired classification, then all required U.S. tax and information returns of each affected person as defined in Section 4.02 of Rev. Proc. 2009-41) were filed timely or within 6 months of the due date of the respective return (excluding extensions) as if the entity classification election had been in effect on the requested date. No U.S. tax or information returns were filed inconsistently with those described in the prior sentence.
Form 8832 Check-the-Box Election Relief for Late Change of Election

- Rev. Proc. 2010-32 Election with Incorrect Number of Owners
  1. Foreign entity files election to be classified as a foreign partnership based on reasonable assumption that it had two or more owners as of the effective date of election and then it is later determined that the foreign entity only has one single owner, the IRS will allow a deemed election to classify the foreign entity as a foreign DRE
  2. Foreign entity files election to be classified as a foreign DRE based on reasonable assumption that it had one owner as of the effective date of the election and it is later determined that the foreign entity has two or more owners, the IRS will allow a deemed election to classify the foreign entity as a foreign partnership

- Requirements for late election change relief
  1. The entity and the entity’s owners file original or amended U.S. Federal income tax returns consistent with the change in the classification
  2. Amended tax returns are filed by the close of the statute of limitations
  3. Corrected Form 8832 with late change of election box checked is filed and attached to the amended tax returns
U.S. Federal tax consequences of filing the election:

1. Partnership to corporation – Partnership contributes all assets and liabilities to corporation and then makes liquidating distribution of the stock to the former partners

2. Corporation to partnership – Corporation makes liquidating distribution of all assets and liabilities to the shareholders who then contribute them to the partnership in exchange for partnership interests

3. Corporation to DRE – Corporation makes liquidating distribution of all assets and liabilities to sole shareholder

4. DRE to corporation – Sole member contributes all assets and liabilities of DRE in exchange for stock of the corporation
Form 8832 Check-the-Box Election
Completing Page One

- Need to obtain a U.S. FEIN for the foreign entity to report on the Form 8832
- Name, address and U.S. FEIN (required) for foreign entity filing the election
- Check box to indicate address change, late election relief under Rev. Proc. 2009-41 or late change of election under Rev. Proc. 2010-32
- Line 1 Type of election – Indicate whether initial election or change in election
- Line 2a – If change in election, was the prior election filed with an effective date in the last 60 months?
- Line 2b – If election was filed with effective date within last 60 months, was the prior election effective on date of formation of a newly formed entity? If no, then a change in election is not allowed.
- Line 3 – Does the entity have more than one owner? If yes, then entity can elect to be a corporation or partnership. If no, then entity can elect to be corporation or DRE.
- Line 4 – If entity has one owner, provide name and U.S. taxpayer ID number.
- Line 5 – If entity is owned by one or more affiliate entities that file a U.S. consolidated tax return, provide name and U.S. FEIN of the common parent corporation.
Form 8832 Check-the-Box Election
Completing Page Two, Part I Election Information

- Line 6 – Type of Entity
  1. A foreign eligible entity electing to be classified as an association taxable as a corporation.
  2. A foreign eligible entity electing to be classified as a partnership.
  3. A foreign eligible entity with a single owner electing to be disregarded as a separate entity.

- Line 7 - Country of organization
- Line 8 - Effective date of election
- Line 9 – Name and title of contact person
Form 8832 Check-the-Box Election
Completing Page Two, Part I Election Information

- Penalties of perjury consent statement with signature and date of officer, manager or member of the entity
  1. Must be signed by each member of the electing entity who is an owner at the time that the election is filed, or
  2. By any officer, manager or member of the electing entity who is authorized (under local law or the organizational documents) to make the election. The person signing the election represents to have such authorization under penalties of perjury.
  3. If an election is to be effective for any period prior to the time it is filed, each person who was an owner between the date the election is to be effective and the date the election is filed, and who is not an owner at the time the election is filed, must sign.
Form 8832 Check-the-Box Election
Completing Page Three, Part II

- Late election relief affidavit with statement of reason why election was not filed on time
- Signed and dated statement under penalties of perjury that Rev. Proc. 2009-41, Section 4.01 requirements are satisfied, the person signing the statement has examined the election and accompanying documents, has personal knowledge of the relevant facts and circumstances and that such facts and circumstances are true, correct and complete.
- Part II of Form 8832 must be signed by an authorized representative of the eligible entity and each affected person.
- Affected person is any person who would be required to attach the Form 8832 election to their respective U.S. Federal income tax return and file certain U.S. Federal international tax information returns to report ownership of the foreign entity.
ALISON N. DOUGHERTY
DIRECTOR, TAX SERVICES
ARONSON LLC

Alison N. Dougherty provides tax services as a Director at Aronson LLC. Alison specializes in international tax reporting, compliance, consulting, planning and structuring as a subject matter leader of Aronson’s international tax practice. She has extensive experience assisting clients with U.S. tax reporting and compliance for offshore assets and foreign accounts. She provides outbound U.S. international tax guidance to U.S. individuals and businesses with activities in other countries. She also provides inbound U.S. international tax guidance to nonresident individuals and businesses with activities in the United States. She has worked extensively in the area of U.S. international tax reporting and compliance with the preparation of the U.S. Federal Forms 5471, 926, 8865, 8858, 5472, 1042, 1042-S, 8621, 8804, 8805, 8813, 8288, 8288-A, 8288-B, 1116, 1118, 1120-F, 1040-NR, 3520, 3520-A, 2555, 5713, 8832, 8833, 8840, 8843, 8854, 8938 and FBAR. She has counseled U.S. taxpayers regarding the outbound formation, capitalization, acquisition, operation, reorganization and liquidation of foreign companies. She has significant experience with U.S. Federal nonresident tax withholding, foreign partner tax withholding and FIRPTA withholding. She works closely with nonresident individuals and businesses regarding inbound U.S. real property investment. She often assists U.S. taxpayers with IRS amnesty program disclosures of offshore assets and foreign accounts.

Alison completed the LL.M. (Master of Laws) in Securities and Financial Regulation in 2004 with academic distinction at Georgetown University Law Center. She completed the LL.M. (Master of Laws) in Taxation in 2000 and the Juris Doctor in 1999 at the University of Denver College of Law. She completed a Bachelor of Arts degree in Foreign Language in 1995 at Virginia Commonwealth University.
• Corporate tax rate reduced from 35% to 20%
  • Senate bill would take effect for taxable years after 12/31/2018.

• Full Expensing
  • Immediate 100% deduction on certain (generally tangible) assets placed in service after 9/28/2017 and before 1/1/2023.
Tax Reform – Shift to a Territorial Regime

- Participation Exemption

- One-Time Repatriation Tax
U.S. would transition from worldwide to territorial tax system.

• 100% deduction for “foreign source” dividends received by U.S. corporations from at least 10%-owned non-U.S. subsidiaries.

  • “Foreign source” earnings exclude income effectively connected with a U.S. trade or business or received from 80%-owned U.S. corporations.

  • No deduction for amounts treated as dividends in U.S. when deductible in local jurisdiction.

  • No U.S. foreign tax credits allowed with deduction-eligible dividends.
• All accumulated non-U.S. earnings deemed repatriated whether distributed or not.

  • Earnings representing “cash” taxed at 14% in the House bill, 14.5% in the Senate bill.

  • Other earnings taxed at 7% in the House bill, 7.5% in the Senate bill.

  • Taxpayers can elect to pay the tax over an 8-year period.
• IP Box Provision

• Tax-Free Repatriation of Assets
• U.S. corporations effectively taxed at 12.5% for “foreign-derived intangible income.”

• In general, foreign-derived intangible income is U.S. corporation’s net income derived from sales of goods and provision of services to unrelated foreign persons less 10% of corporation’s depreciable asset basis.

• Potentially applies to more than IP-related income.
• If CFC of U.S. multinational distributes IP to U.S. parent, fair market value of IP treated as not exceeding CFC’s tax basis in such IP.

• If distribution is not a dividend (i.e., treated as a stock redemption), U.S. parent’s tax basis in CFC stock is increased by amount of distribution that would otherwise have been includible in income.

• IP includes (i) a patent, invention, formula, process, design, pattern, or know-how; (ii) a copyright, literary, musical, or artistic composition; (iii) a trademark, trade name, or brand name; (iv) a franchise, license, or contract; (v) a method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data; (vi) any item similar to (i)-(v); or (vii) certain computer software (excluding databases).

• Only applies to distributions made by a CFC before last day of CFC’s third taxable year beginning after 12/31/2017.

- New Global Minimum Tax Provision
- New “Base Erosion and Anti-Abuse” Tax
- Thin Capitalization Rules
- New Hybrid Mismatch Rule
• New “Global Intangible Low-Taxed Income” tax or “GILTI” tax.

• Designed to target non-U.S. income derived from intangibles earned by CFCs of U.S. multinationals.

• Tax equal to 10% of CFC’s net income less a “fixed return.” Fixed return is equal to 10% of CFC’s tax basis in depreciable tangible assets in given year.

• Tax imposed on U.S. shareholder of CFC.

• 80% of foreign tax credits may be claimed against amount included as GILTI by U.S. shareholder.
Tax Reform – New “Base Erosion and Anti-Abuse” Tax

• U.S. corporations must pay tax equal to excess of 10% of its taxable income (less “Base Erosion Tax Benefits”) over its regular tax liability reduced by certain tax credits (the “BEAAT”).

• “Base Erosion Tax Benefits” are deductions arising from payments to related non-U.S. persons, generally excluding payments for cost of goods sold and inventory.
  
  • Relatedness provides for a 25% threshold taking into account indirect ownership and a series of broad ownership attribution rules.

• BEAAT limited to corporate multinationals with (i) worldwide annual group gross receipts of $500 million+ and (ii) at least 4% of U.S. group’s annual deductions arising from base erosion payments.
• Rule 1: Applies to all taxpayers such that annual net business interest deductions limited to 30% of adjusted taxable income.

• Rule 2: Applies only to multinational groups limiting net interest deductions of U.S. members to no more than amount causing U.S. member’s debt-equity ratio to be 110% of worldwide group’s debt-equity ratio.

• If both applicable, whichever rule results in less interest deductions by U.S. members prevails.
• In general, proposal would deny a deduction for any interest or royalty paid to a related party that does not include such amount in income (or is permitted a deduction) under the tax law of the related party’s country of tax residence.

• In general, the payor is “related” to the recipient if the payor controls or is controlled by the recipient.

  • “Control” is defined as 50% of the vote or value of the relevant entity’s equity taking into account indirect ownership and a series of ownership attribution rules.
• If a U.S. corporation transfers substantially all the assets of a foreign branch to a 10%-owned foreign corporation, the U.S. corporation must include in income the net losses of the foreign branch incurred since December 31, 2017 that were taken by the U.S. corporation as deductions.

• The amount of loss recaptured cannot exceed the amount allowed as a deduction under the participation exemption for the taxable year of the transfer, although any amount not included is carried forward.
Taxes attributable to a foreign branch are treated as belonging to a separate basket for foreign tax credit limitation purposes.

The source of income for sales of inventory is determined solely by reference to the location(s) where production activities took place.

Workforce in place, goodwill (U.S. and foreign), and going concern value constitute intangible property subject to section 367(d).

For purposes of section 482, the IRS can determine an arm’s-length price for intangible property using the “reasonable alternative principle” (already exists in regulations).

The realistic alternative principle is predicated on the notion that a taxpayer will only enter into a particular transaction if none of its realistic alternatives is economically preferable to the transaction under consideration.
What Does All This Mean?

• Foreign corporate subsidiaries are less attractive.
  • GILTI tax
  • BEAAT
  • No IP box
  • Subpart F still exists
  • Worldwide thin capitalization

• Foreign branches are more attractive.
  • Avoids GILTI, BEAAT, and Subpart F
  • Eligible for IP box rate of 12.5%
  • Full expensing as a deduction against taxable income
  • Less likely to be limited in interest deductibility

• Coming back on-shore?
  • IP repatriation “holiday”
  • Inbound liquidation under section 332
  • Inbound tax-free spin-off?
Thank You

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