Non-US Business Entity Selection – How U.S. and Global Taxation Regimes Impact the Decision

Making Critical Tax-Based Choices Regarding Branch Offices, CFCs, Disregarded Entities, Joint Ventures, and Check-the-Box

THURSDAY, JUNE 12, 2014, 1:00-2:50 pm Eastern

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Non-U.S. Business Entity Selection - How U.S. and Global Taxation Regimes Impact the Decision

June 12, 2014

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NON-U.S. BUSINESS ENTITY SELECTION - HOW U.S. AND GLOBAL TAXATION REGIMES IMPACT THE DECISION

Jerry Jonckheere, Plante Moran
Douglas Nakajima, Smart Devine
Role Of Tax Planning

• Tax considerations are just one component of an internationally active business’ financial and operational plan.

• Global tax costs must be minimized to maximize after-tax profits and cash flow.

• Effective tax planning complements and adds value to a business plan.

• Knowing how to work with U.S. and foreign tax laws increases the effectiveness of a business plan.
Role Of Tax Planning

• U.S. Tax Planning is Unique when compared to other jurisdictions as we have a WORLDWIDE taxation system while most other countries have a TERRITORIAL taxation system.

• The difference between the two systems is that all income earned by a subsidiary of a U.S. taxpayer will, eventually, be taxed in the U.S.. As a result, operations in a low tax jurisdiction will result in a temporary benefit, but not a permanent benefit.
Role Of Tax Planning (Cont.)

- Two major U.S. tax revisions in 1986 and 1998 have significant impact on decisions that U.S. businesses must make when selecting types of business entities overseas.
  - 1986 major revisions in the U.S. foreign tax credit rules
  - 1998 “check-the-box” rules
- These revisions make the already complex U.S. worldwide taxation system even more complex. The revisions allows for various tax strategies for international subsidiaries:
  - Structuring to accelerate or defer income are used, depending on the circumstances.
  - Transfer Pricing may be used to maximize or minimize income in a jurisdiction, depending on the circumstances
  - Finding favorable treaty provisions is important
Role Of Tax Planning (Cont.)

- Recent trends in international taxation have added even more complexity to determining correct structures from a tax perspective:
  - FATCA has increased awareness of unreported income
  - The OECD BEPS (Base Erosion and Profit Shifting) Initiative seeks to identify (and minimize) methods used by companies to reduce their tax bills
  - More jurisdictions are added substance requirements to receive treaty benefits
Planning Steps For Foreign Investment

**Step One: Understand the business domestic and foreign operations**

- Are foreign operations generally profitable?
- Can foreign tax credits currently be fully used?
- Are transfer prices between related companies appropriate?
- Where does the business want its cash to be, i.e. in the U.S. or overseas?

**Step Two: Understand available structuring options**

- Evaluate foreign jurisdiction’s national/local tax and commercial laws
- Understand legal entities that are available
- Withholding rates and availability of U.S. treaty benefits (including limitation on benefit clauses)
- Availability of low tax country treaties, if appropriate
Planning Steps For Foreign Investment (Cont.)

Step Three: Explore tax alternatives

- Branch, partnership, disregarded entity, or controlled foreign corporation
- Ownership directly or through domestic or foreign holding company
- Capital structure (debt/equity)

Step Four: Model tax impacts

- Develop a comparative tax model
- Evaluate financial impact of structures
Phases Associated With Outbound Investments

- **Export/import goods and services**
  - Direct sales to foreign customers for own account
  - Typically, no permanent establishment is deemed to occur in countries protected by treaties
  - Generally, no income tax filings are necessary (though there may be informational filings and customs or value-added tax implications).

- **Joint venture/partnership**
  - Local presence established with local partner
  - Establishing legal entity in the foreign country is generally recommended for tax (and legal) reasons.
  - Joint ventures can be structured as partnerships or limited liability companies.
Phases Associated With Outbound Investments (Cont.)

• **Branch**
  - U.S. company will generally be deemed to have a “permanent establishment” or “PE”
  - U.S. company with “PE” will be subject to tax in local country on income allocable/attributable to PE.
  - While not a separate legal entity, ‘contracts’ are encouraged

• **Controlled foreign corporation (CFC), disregarded entity (DRE) or controlled foreign partnership (CFP)**
  - Local presence is established through formation of a legal entity.
  - U.S. parent’s earnings are not subject to tax in the local country.
  - Local earnings will be taxable in the U.S.. A ‘check-the-box’ election will generally allow a choice of current taxation or deferral.
U.S. Parent is subject to foreign taxation on income allocable to branch operations.

Ownership: Full

Foreign Branch

U.S. Parent is subject to current U.S. and foreign taxation on income
Ownership: Full or partial

Partnership

Taxed like a partnership but with limited liability in foreign country
Ownership: Full

Disregarded Entity

Foreign Corporation

Deferral of U.S. tax on foreign corporation's profits until repatriated to U.S.
Ownership: Full or partial
Comparison Of Sample Effective Tax Rates

-- U.S. rate = 35% corporate/39.6% individual/23.8% qualified dividend
-- Foreign rate = 30% (no withholding taxes assumed)

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<td>Foreign</td>
<td>50.47%</td>
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Foreign
LEGAL & TAX CHARACTERISTICS OF FOREIGN ENTITIES THAT AFFECT YOUR OPTIONS
Permanent Establishment

- Businesses must be concerned with several levels of filing requirements when doing business in a foreign country.
- Issues include customs related issues (which are outside the scope of this webinar), income taxes, value added taxes, withholding taxes, and/or business taxes.
- Local rules control when and what taxes are due to that country’s treasury.
- PE occurs when a company has a “physical presence” in a country, i.e. a fixed place of business; however, officers with contract approval authority, entrepreneurship-related activities, or activities of key employees may also result in PE.
  - Countries are becoming more aggressive in finding PEs and enforcing existing laws.
- When a treaty exists, companies may rely on the treaty definition of permanent establishment (PE).
Check-The-Box Election

• The check-the-box election was enacted in 1998 in response increasing use of LLCs as a result of state adoption of LLC legislation.

• LLCs are limited liability companies that meet the tax definition of a partnership.

• Limited liability, centralized management, free transferability of shares, unlimited life

• The election was so named because it can be elected by “simply” checking a box on Form 8832.

• A check-the-box election ONLY impacts U.S. taxation of a foreign entity, and generally does not impact the foreign taxation of an entity.
Check-The-Box Regulations

• Reg. §301.7701-3 allows entities “not classified as a corporation” to “elect its classification for federal tax purposes.”
  • The election allows entities to be treated as (1) associations, (2) partnerships or (3) disregarded entities
• Foreign entities will default to:
  • Being taxed as an association, if all members have limited liability;
  • Being taxed as a partnership, if they have two or more members and at least one member does *not* have limited liability; or
  • Being disregarded as an entity, if their single owners do not have limited liability.
• Only “per se” entities cannot make a check-the-box election to change their default classification
Check-The-Box Regulations (Cont.)

• Reg § 301.7701-2 defines the entities that are not eligible to make a check-the-box election (*per se* corporations).

• *Per se* entities are, generally, entities that have no restrictions on the transfer of shares. The free transferability of shares was one of the four pre-check-the-box factors to differentiate between entities taxable as partnerships or as corporations and still applicable in the check-the-box regulations.
“Per Se” Corporations And Disregarded Entities

• A *per se* corporation is a foreign corporation that cannot make a check-the-box election to be treated as a flow-through, for U.S. tax purposes.

• A *flow-through* entity is a foreign entity that flows its income through to its U.S. parent, either as a partnership (two or more owners) or as a disregarded entity (wholly owned entity).

• A *controlled foreign corporation* is a foreign corporation that is owned (1) more than 50% by (2) U.S. taxpayers that own 10% or more.
  • 10%-or-greater U.S. corporate taxpayers can benefit from *indirect* foreign tax credit.
Per Se vs. Check-the-Box Eligible

• In the United Kingdom and many of its former colonies, a plc (public limited company) is a *per se* company. A Ltd (limited company) is check-the-box-eligible similar to the U.S. LLC.

• In Spanish-speaking countries, an S.A. (Societe Anonyme) is the *per se* company. An s.r.l. (Sociedad de Responsabilidad Limitada) is check-the-box-eligible.
  • Variations of the S.A., such as S.A. de C.V. do not remove it from the *per se* companies.
Is It Butter?

- In some countries, an entity’s free transferability of shares can be modified in its legal agreements.
  - In Mexico, an S.A. de C.V. is *generally* a *per se* corporation, but can be check-the-box-eligible depending on how its variable capital is defined.
  - In France, an S.A.R.L. is *generally* check-the-box eligible, but can be a *per se* corporation if the share provisions are expanded to be freely transferable.
  - In Cyprus, Hong Kong and Jamaica, a plc may include limited companies that have free transferability of shares.
  - In Switzerland, a GmbH may be referred to as an S.A.R.L. or S.A.G.L. depending on whether you are in the north or south.
Multi-Lingual Countries: Paises Multilingües

- Entities are sometimes have multiple names in countries that are multi-lingual.

  - Switzerland’s *per se* corporation is listed as an Aktiengesellschaft (AK), but a Societe Anonyme is another name for the AK and is also a *per se* corporation.
  
  - Indonesia’s Perseroan Terbatas (PT) may also be referred to as a Naamloze Vennootschap (NV) (Dutch version).
Legal Issues of Entity Selection

• Branch operations do not generally limit the legal liability of its U.S. parent company.

• Contracts can generally not be made between a parent and a branch, which limits a company’s flexibility in pre-defining transfer pricing and risk relationships.

• Income may be allocated or attributed to a branch under different rules, which could result in higher local taxation.
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U.S. TAX ADVANTAGES AND PITFALLS OF ENTITY CHOICE

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Foreign Tax Credits

• The U.S. worldwide tax system taxes *all* income earned by a U.S. company, regardless of whether it is earned in or outside of the U.S. However, foreign taxes paid to a foreign country may be deducted or, optimally, used as a credit against the foreign income included on the U.S. return.

• The foreign tax credit can be a *direct* or *indirect* credit.
  – A direct credit for taxes paid directly by a U.S. company (or branch) or by a foreign subsidiary treated as a flow-through entity by its U.S. parent
  – An indirect credit for taxes paid by a CFC or foreign corporation with a 10%-or-greater corporate shareholder.
Foreign Tax Credits: Direct Credit

- ForeignCo earns $100 and pays $30 in local taxes. ForeignCo is treated as a disregarded entity by its U.S. parent taxed as an S corporation.
  - USSCorporation flows the $100 in income and $30 in foreign taxes paid to its USShareholder.

  - USShareholder reports $100 in income and calculates a preliminary U.S. tax of $39.60 (39.6% tax rate). USShareholder will generally be allowed a foreign tax credit of $30, which reduces his U.S. income tax to $9.60.

  - USShareholder pays $39.60 in income taxes ($30 to foreign treasury and $9.60 to the IRS).

  - When ForeignCo distributes the $70 (i.e. $100 less $30 in taxes paid), there will be no further income tax.
Foreign Tax Credits: Indirect Credit

- ForeignCo earns $100 and pays $30 in local taxes. ForeignCo is treated as a CFC by its U.S. parent taxed as a C corporation.
  - When ForeignCo pays a dividend of $70, USCCorporation will report the $70 as income on its return.
  - USCCorporation may also elect to report an “IRC §78 gross-up” of $30 if it wishes to claim a foreign tax credit. This $30 is reported on Form 1120, Schedule C.
  - USCCorporation reports $100 in income and calculates a preliminary income tax of $35 (35% corporate rate). USCCorporation may generally claim a foreign tax credit of $30, which will reduce its U.S. income tax to $5.
  - USCCorporation pays $35 in income taxes ($30 to foreign treasury and $5 to the IRS).
Foreign Tax Credits: Limitations

- While the previous examples make the foreign tax credit computation seem easy, there are three limitations and significant complexity that must be considered when computing the limitations:
  - Foreign taxes paid: Only foreign income taxes are creditable against a taxpayer’s U.S. income taxes, and only those income taxes that are compulsory.
    - Complexity – determining creditable taxes
  - Foreign source income: The U.S. foreign tax credit is limited to the U.S. effective tax rate. If the U.S. effective tax rate is 35%, and you are paying taxes in a country with an effective tax rate of 50%, you will not get a full credit for the taxes paid in the foreign country.
    - Complexity – determining correct foreign source income and managing carryovers (OFLs and ODLs)
  - U.S. obligation: Your foreign tax credit may never result in a negative U.S. tax liability.
    - Limitation can be effected by favorable qualified dividend rate
Anti-Deferral Rules

• CFCs are subject to a number of anti-deferral rules. In general, these rules will accelerate certain classes of income or, potentially, all income.

• Subpart F rules will accelerate passive income (interest, dividends, certain rents, royalties, etc.) above certain thresholds (i.e. 5% of active gross receipts).

• IRC 956 will accelerate all income if the:
  – CFC loans money to its U.S. parent
  – U.S. parent obtains a loan from a third party and uses 2/3 or more of the CFC’s stock or assets as collateral
  – CFC invests in more than 25% of a U.S. company
Other FTC Rules

• The FTC rules are very complex and each company’s situation will be different. These rules work to decrease (or increase) foreign source income that may decrease or increase the foreign tax credit utilized.

• Reg § 1.861-8 allocations – certain expenses of the domestic company must be allocated to foreign source income. These expenses are referred to as “stewardship expenses.”

• Reg § 1.861-9 interest expense allocations – interest expense of the parent company may be allocated to foreign source income if the parent is the primary borrower for the group.

• IRC § 863(b) export profits – FSI may be increased by profits of US manufactured profits sold to a non-U.S. destination.

• Allocations of stewardship and interest expense occur annually whether there are other foreign sources of income or not. Accumulated expenses are deemed OFLs (overall foreign losses).
Foreign Losses

• Foreign losses may generally be used to reduce U.S. income taxes, when the foreign entity is a branch, partnership or disregarded entity.

• Foreign losses incurred by a foreign corporation or CFC will not reduce U.S. parent company income.
Reporting Of Foreign Income And Losses

- Other issues to consider:
  - §987 currency gains and losses
  - Translation of foreign taxes
  - Rules related to recapture of branch losses
    - Branch loss recapture rules (see, generally, Sect. 367(a)(3)(c) and Treasury Reg. 1.367(a)-6t
    - OFL recapture rules (see, generally, Sect. 904(f)(3))
    - Dual consolidated loss rules (see, generally, Sect. 1503(d))
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TAX ANALYSES FOR ENTITY SELECTION
Comparison Of Sample Effective Tax Rates

-- U.S. rate = 35% corporate/39.6% individual/23.8% qualified dividend
-- Foreign rate = 30% (withholding taxes ignored)

U.S.

C Corp – CFC/Flow-Through

-- CFC/FT earns $100 and pays $30 local tax.
-- CFC/FT dividends $70 to C Corp parent.
-- C Corp pays an additional $5 in tax (i.e. $35 tentative tax less $30 foreign tax credit.
-- C Corp dividends $65 to individuals holding stock. Individuals pay an additional ($65 * 23.8% =) $15.47.

50.47%

Foreign

-- Total taxes paid = $30 + $5 + $15.47 = $50.47.
Comparison Of Sample Effective Tax Rates (Cont.)

-- U.S. rate = 35% corporate/39.6% individual /23.8% qualified dividend
-- Foreign rate = 30% (withholding taxes ignored)

C Corp – Flow-Through

-- FT earns $100 and pays $30 local tax.
-- FT dividends $70 to C Corp parent.
-- C Corp pays an additional $5 in tax (i.e. $35 tentative tax less $30 foreign tax credit.
-- C Corp dividends $65 to individuals holding stock. Individuals pay an additional ($65 * 23.8% =) $15.47.

50.47%

-- Total taxes paid = $30 + $5 + $15.47 = $50.47.
Comparison Of Sample Effective Tax Rates (Cont.)

-- U.S. rate = 35% corporate/39.6% individual/23.8% qualified dividend
-- Foreign rate = 30% (withholding taxes ignored)

Flow-Through – CFC

-- CFC earns $100 and pays $30 local tax.
-- CFC dividends $70 to FT parent.
-- FT passes dividend to partners/members/shareholders.
-- Individuals pay an additional ($70 * 23.8% =) $16.66.

Total taxes paid = $30 + $16.66 = $46.66.
Comparison Of Sample Effective Tax Rates (Cont.)

-- U.S. rate = 35% corporate/39.6% individual/23.8% qualified dividend
-- Foreign rate = 30% (withholding taxes ignored)

Flow-Through – FT

-- FT earns $100 and pays $30 local tax.
-- FT dividends $70 to FT parent.
-- FT passes income and tax characteristics to partners/members/shareholders.
-- Individuals report $100 in income and pays an additional ($100 * 39.6% = $39.6 less $30 foreign tax credit =) $9.60.

Total taxes paid = $30 + $9.60 = $39.60.
How GE Uses an “Efficient” Tax Model

USCo has income that is sheltered by favorable U.S. tax credits, like R&E credits.

Low Tax Holdco acts as a financing company or intangible holding company that charges interest or royalties to foreign Operating companies.

Foreign Opcos pay interest or royalties to Low Tax Holdco to reduce taxable income in local jurisdictions.
Inversions – A brief note of caution.

Outbound movement of an existing U.S. business (corporation or partnership) in transactions known as “Inversions”:

• A foreign corporation is interposed between a U.S. corporation and its shareholders
• Purpose: Allows the U.S. corporation to distribute the untaxed earnings of its foreign subsidiaries to the shareholders of the new foreign parent or reduce future tax liability through deductible payments to the new foreign parent, each without U.S. tax.

Inversion Rules (367 and 7874) introduced to restrict inversions say that foreign shareholders must own at least 20% of the stock. If not, the foreign corporation is treated as U.S. taxpayer (ignoring the inversion.)

Inversion rules focused on mega-businesses making proper use of current law, but can affect U.S. businesses of ANY size.

Where U.S. businesses move offshore by means of a combination with a foreign corporate entity, inversion exposure should be reviewed.
CROSS-BORDER TRANSFERS OF ASSETS AND INTANGIBLES

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IRC §367: Gain Recognition Rule

- IRC § 367(a) prevents the avoidance of U.S. tax when appreciated property is transferred to a foreign corporation in a non-recognition transfers.

- IRC § Sect. 367(a)(1) provides that if, in connection with exchange described in sections 332, 351, 354, 356 or 361, a U.S. person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. See also sections 367(c)(2) & (f)
• By not treating a foreign corporation as a corporation (necessary condition for non-recognition treatment), a U.S. transferor generally is required to recognize gain, but not loss, on its outbound transfer of property.

• Transfers of property covered by this general gain recognition rule may be direct, indirect or constructive. Treas. Reg. 1.367(a)-1T(c)

• If a gain is recognized, certain adjustments are made, e.g., basis in assets and stock. See, generally, Treas. Reg. 1.367(a)-1T
Code and regulations provide exceptions to the general gain recognition rule for certain transfers of:

- Assets used by foreign corporation in active trade or business outside U.S.
- Stock in foreign corporation
- Stock in domestic corporation
- Most intangible property transfers governed by Sect. 367(d)
• IRC § 367(d) prevents U.S. taxpayers from deducting substantial research and experimentation costs associated with developing an intangible, and when the intangible is about to start generating profits, removing the income stream associated with the intangible from U.S. taxing jurisdiction by transferring it to a foreign corporation in a non-recognition transaction.
• Sect. 367(d) applies to a U.S. person’s transfer of intangible property to a foreign corporation in a Sect. 351 or Sect. 361 transfer, and treats the U.S. person as having sold such property in exchange for annual payments contingent on productivity, use or disposition of property.

• Intangible property is defined by reference to Sect. 936(h)(3)(B). Sect. 936(h)(3)(B) defines an intangible as any (i) patent, invention, formula, process, design, pattern or know-how; (ii) copyright, literary, musical or artistic composition; (iii) trademark, trade name or brand name; (iv) franchise, license or contract; (v) method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list or technical data; or (vi) any similar item that has substantial value independent of the services of any individual.
Transfer Of Intangibles (Cont.)

- Certain intangible property is excluded from ambit of Sect. 367(d), including foreign goodwill and going concern value. See, generally, Treas. Reg. 1.367(d)-1T(b)
- Must be transfer of property; compare Rev. Rul. 69-156 with *E.I. du Pont De Nemours and Co.*, 471 F.2d 1211 (Ct. Cl. 1937)
- Deemed annual payments generally must continue over the useful life of property (not to exceed 20 years), and must be commensurate with income.
- Payments generally will be foreign-source, ordinary income; to the extent that the intangible is used abroad, and annual inclusions are treated as royalties for purposes of foreign tax credit. See sections 367(d)(2) and (3)
- Special rules related to subsequent dispositions by transferee foreign corporation of intangibles and dispositions by U.S. transferor of transferee foreign corporation’s stock
- Regulations permit sale treatment under certain limited circumstances. See, generally, Treas. Reg. 1.367(d)-1T(g)(2)
Debt vs Equity

- Most jurisdictions place a limit on the amount of debt that a foreign parent can fund a company with. The goal is to reduce interest expense with dividends payable to the parent.

- The U.S. regime, IRC § 163(j), is actually lenient compared with most jurisdictions as lost interest expenses is delayed while most jurisdictions permanently disallow the interest expense deduction.
## U.S. Tax Planning Strategies

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<th>Tactics</th>
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| Obtain current benefit in U.S. of start-up losses | • Structure foreign investment to qualify as a flow-through entity for U.S. income tax purposes  
  • Select U.S. tax accounting methods to optimize current and future benefits  
  • Position losses to maximize state tax benefits  
  • Consider application of dual consolidated loss rules |
| Reduce foreign taxes | • Consider use of intermediary holding company to reduce withholding taxes  
  • Consider debt-to-equity capital structure  
  • Negotiate foreign tax incentives prior to start-up  
  • Minimize importation taxes and duties  
  • Consider pricing of related-party supplier product or services  
  • Evaluate related-party leasing and licensing |
| Maximize use of U.S. foreign tax credits | • Maximize creditable foreign taxes for U.S. tax purposes  
  • Minimize foreign tax credits not available to offset other low-taxed foreign source income  
  • Minimize unreimbursed expenses allocated to foreign income, where associated foreign taxes are not creditable currently in U.S. |
| Reduce or defer recognition of taxable income | • Consider ownership through intermediary holding company  
  • Consider distribution companies  
  • Consider in-kind countertrade transactions  
  • Consider contract manufacturing  
  • Consider domestic international sales corporation (DISC) to reduce taxes on exports  
  • Minimize mismatching of currency gains and losses |
RE-EVALUATING A PREVIOUS ENTITY SELECTION

Jerry Jonckheere, Plante Moran
Douglas Nakajima, Smart Devine
Re-evaluating A Previous Choice

There often comes a time when a prior entity choice must be re-evaluated.

• A foreign entity may have been treated as a “flow-through” during its early years, to allow the parent company to benefit from its losses.

• A prior election may simply have been missed or not made.

• A U.S. S corporation realizes that it is missing a direct credit opportunity on an entity treated as a CFC.

Whether the re-evaluation is due to an oversight, missed assumptions or a change in the operations of the foreign subsidiary, it is important to understand the tax implications of changing an entity choice.
Rev. Proc. 2009-41 allows taxpayers to make a late check-the-box election when the following conditions are met:

- The election is made within three years and 75 days of the requested effective date of the election.
- The taxpayer has treated the foreign entity consistently with the requested tax treatment.

Example: Taxpayer (S corporation) forms a German GmbH on Jan. 1, 2010 and treats the GmbH as a DRE on its tax return by properly filing Form 8858. On Feb. 1, 2013, it is discovered that no check-the-box election was made. The taxpayer may file a Form 8832 to elect DRE status for the GmbH.

Please refer to Rev. Proc. 2009-41 for required protocols and conditions for filing.
“9100 Relief”

When the conditions for automatic relief under Rev. Proc. 2009-41 cannot be met, taxpayers may request “9100 relief.”

- 9100 relief is requested through a private letter ruling request process. The information requested includes contemporaneous documents, affidavits, tax returns, etc.
- 9100 relief requires a user fee that depends on the type of relief being requested.
- Generally, the taxpayer must have relied upon professional advice or actions.

Example: Taxpayer meets with advisors and determines that a check-the-box election should be made for a foreign subsidiary. However, when the tax returns were prepared, the advisor prepared Form 5471 (for controlled foreign corporations) rather than Form 8858. Because the preparation was done in error after a decision was made, the taxpayer should be able to get 9100 relief.
The taxpayer may wish to re-evaluate a foreign flow-through entity after it becomes profitable. Companies may utilize losses in the early years of a foreign entity’s existence, but making an election to be taxed as a CFC has tax implications that must be considered.

- Recapture of flow-through (branch/DRE/partnership) losses:
  - If a flow-through’s losses were reported on its parents return, then the losses may have to be recaptured when the election is made (IRC §367(a)(3)(C)).
  - Previously *unrecaptured* losses must be reported as gains on the parent’s return. Treatment depends on whether the income was ordinary or capital.
  - Interacts with the OFL (overall foreign loss rules) of IRC §904(f)(3)
The taxpayer may wish to make a check-the-box election for a foreign corporation to treat it as a “flow-through” entity. When this choice is made, there are a number of tax implications.

- The foreign corporation is treated as liquidating and distributing its assets to its parent. This process may require the application of:
  - IRC §311(b), related to the deemed sale of assets at FMV in a corporation
  - IRC §1248, related to the distribution of E&P and Tax Pools of a foreign corporation to a U.S. C corporation

The treatment will depend on the ownership structure and will have significantly different results, depending on the facts and circumstances.
Final Thoughts

The U.S. tax system is complex but it also offers planning opportunities for those that properly plan by selecting the correct entity choices (in fact, if you do a good job of it you may even be asked to explain your strategies in front of Congress). 😊

- Most middle-market companies will benefit from a straight flow-through taxation model (i.e., S corporation or LLC in the U.S., and a DRE or partnership for foreign entities).
- Companies with significant foreign growth plans may benefit from the deferral aspects of the U.S. tax system.

We have not covered other important, but niched, topics like planned IPOs or other exit strategies, as they are typically influenced more by foreign laws than by U.S. tax planning.
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