



Recent U.S. Tax Changes relevant to Israeli companies

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Federal



Latest Treasury Regulations & IRS Announcements

IRS releases initial list of Audit Campaigns:

-  Enhanced focus on U.S. inbound Limited Risk Distributors (“LRD”)
-  Reinforces the necessity for proper documentation:
Ensure that C-class executives’ actual activities are in line with Company policy
 -  Intercompany agreements
 -  Written Company policy delineating business activities in each entity
 -  Forms: 1120, 5471 & 5472
 -  Transfer Pricing studies

Latest Treasury Regulations & IRS Announcements

New reporting obligations for foreign-owned U.S. disregarded entities (“DRE”)

- DREs are now required to report and file Form 5472
- Effective for taxable years on or after 1 January 2017



Latest Treasury Regulations & IRS Announcements

Final §385 Regulations

- Requires contemporaneous written documentation of four indebtedness factors (applicable to related party instruments issued on or after 1 January 2018)
- Target intercompany leveraging transactions (generally applicable to debt issued after 4 April, 2016)



Latest Treasury Regulations & IRS Announcements

Final §385 Regulations – Four Indebtedness Factors

Unconditional Obligation to Pay

- Unconditional and legally binding obligation to pay
- Fixed or determinable sum
- On demand or at one or more fixed dates

Ability to Repay

- **As of date of issuance, issuer's financial position supports reasonable expectation of repayment**
- **Taking into account all relevant circumstances (and ability to refinance may be taken into account)**
- Certain provisions applicable to nonrecourse obligations
- Annual credit analysis may be required if the issuer issues more than one instrument on any day within the 12-month period
- Additional documentation required for material events

Creditor's Rights

- **Creditor has right to enforce obligation**
- **Typically includes right to cause or trigger default or acceleration in case of failure to pay**
- **Non-subordination to equity holders**
- Provisions applicable to nonrecourse obligations
- Contained within document or reference to local law

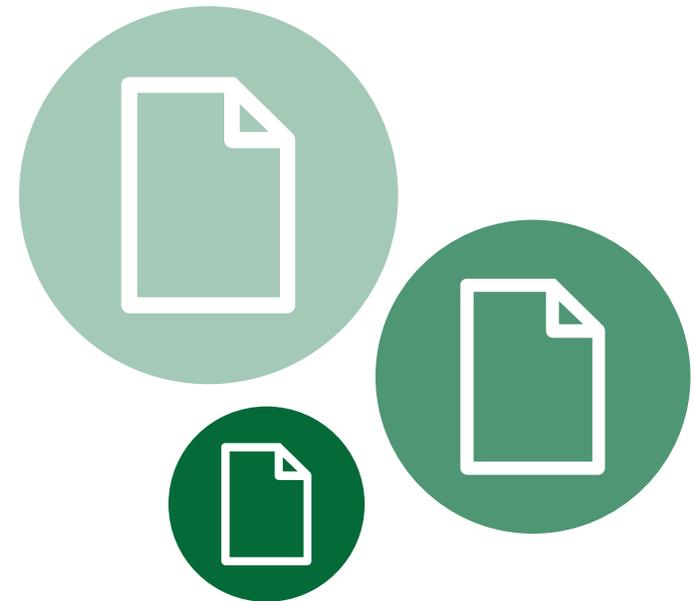
Debtor-Creditor Relationship

- **Written documentation of payments with respect to interest or principal (if relied upon to support debt treatment)**
- **Evidence of holder exercising rights under event of default**
- **Written documentation of decision not to exercise such rights**

Latest Treasury Regulations & IRS Announcements

Final §385 Regulations – Debt Recast Rules

- Debt recast rules – A “covered debt instrument” will be treated as stock in certain “prohibited transactions” (certain M&A and debt repayment transactions)
- New and expanded exceptions:
 - Qualified short term instruments
 - \$50 Million threshold



Latest Treasury Regulations & IRS Announcements

IRS sets new corporate income tax extended due date

- IRS announces 15 October due date
- Beware of certain earlier State due dates
 - Florida, Massachusetts



State & Local



State & Local Tax Trends

Increasing State tax obligations and thus filing Requirements

- The overall trend is the adaption of state laws and regulations to capture e-commerce (i.e. SaaS)



State & Local income Tax Trends

Economic Presence Nexus

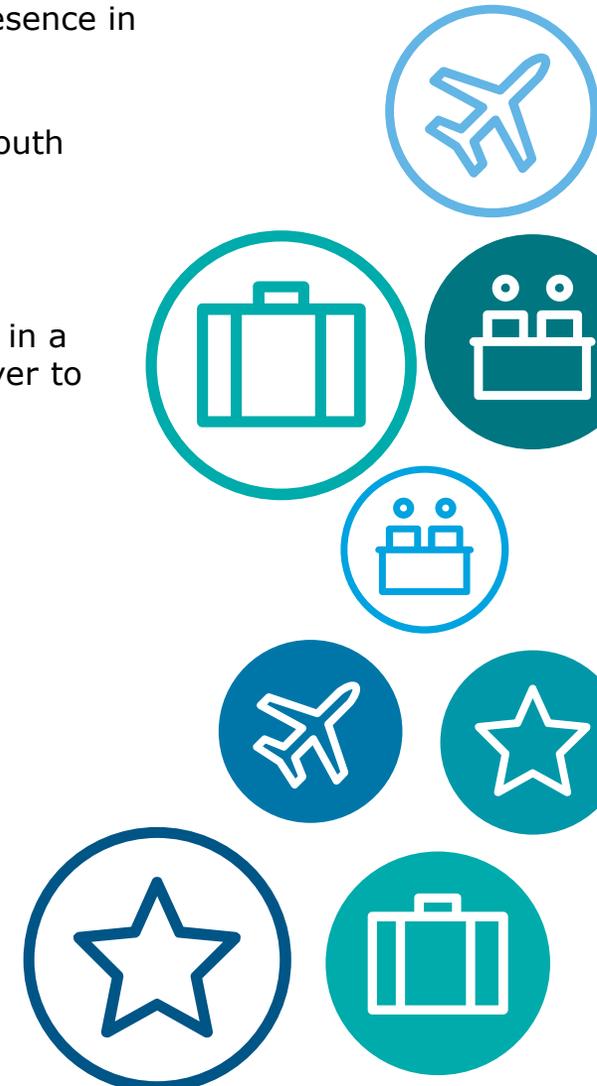
- States are changing the game by redefining what causes a company to have nexus within their state – aka Factor Nexus (Bright-Line) Standards (based on sales threshold)
 - PL 86-272 only applicable to tangible personal property
 - Many states use \$500,000 as the trigger



State & Local income Tax Trends

Economic Presence Nexus

- A growing number of states have statutes or rulings that assert nexus over taxpayers that have an economic presence in the state, even those that lack a physical presence in the state.
- Geoffrey Nexus – Geoffrey nexus applies when licensed intellectual property is used in a state. (Geoffrey, Inc. v. South Carolina Tax Commission 437 S.E. 2d 13, cert. den. 114 S.Ct. 550 (1993)).
- Maine’s explanation of economic nexus
 - “Economic nexus is a short-hand term for the principle that a taxpayer's purposefully directed business activity in a State (other than solicitation of sales activity protected by P.L. 86-272) may be sufficient to subject that taxpayer to income tax in that State regardless of the level – or absence – of physical presence in that State”
- Michigan – “active solicitation”
- Lanco, Inc. v. Director, New Jersey Division of Taxation, 188 N.J. 380 (2006), cert. den. 551 U.S. 1131 (2007)
 - Licensing intangibles creates nexus for New Jersey Corporate Business Tax purposes
 - Quill only applies to sales tax
- Tax Commissioner of the State of West Virginia v. MBNA America Bank, 220 W. Va. 163 (2006)
 - Adopted “significant economic presence” test
 - Bank had engaged in continuous direct mail, telephone solicitation, and promotion in state
 - Court ruled that Quill only applies to sales and use taxes, not to state business franchise tax



State & Local income Tax Trends

Market-Based Sourcing vs. Cost of Performance

Sales should be sourced to the state where the purchaser receives the benefit of the service or where he uses the intangible asset not necessarily where the costs of performance are incurred (i.e. where the service is performed)



Look-through approach

- Based on location of the customer's customer



“Market” for services

- Customer location
- Where the benefit of the service is received by customer
- Where the service is received
- Where the service is delivered



“Market” for intangibles

- Where the intangible is used
- Where the intangible has a business situs
- Where the intangible is domiciled

State & Local income Tax Trends

Market-Based Sourcing vs. Cost of Performance

Reality is that market sourcing can be difficult to apply regardless of whether based on location of delivery, client benefit or something else.

- Based on terms of contract?
- Location from where request for service is made/ordered?
- Based on a look through to the client's customer's location?
- Location from which customer is billed and/or domiciled?
- What level of analysis and data collection is required by a seller?

Consider complex services that appear to benefit an entire organization – Where is the “benefit received” if the customer is a multistate (or multinational) company?

- Cloud computing services
- Accounting and legal services

Look-through approach

- Sourcing receipts based on the location of the customer's customer
- States have adopted this approach either through regulation or enforcement efforts
 - California applies such an approach to mutual fund service providers (Cal. Code Regs. tit. 18, § 25137-14)
 - Such an approach may lead to a large compliance burden for taxpayer's because they may not control the data necessary to accurately source the receipts



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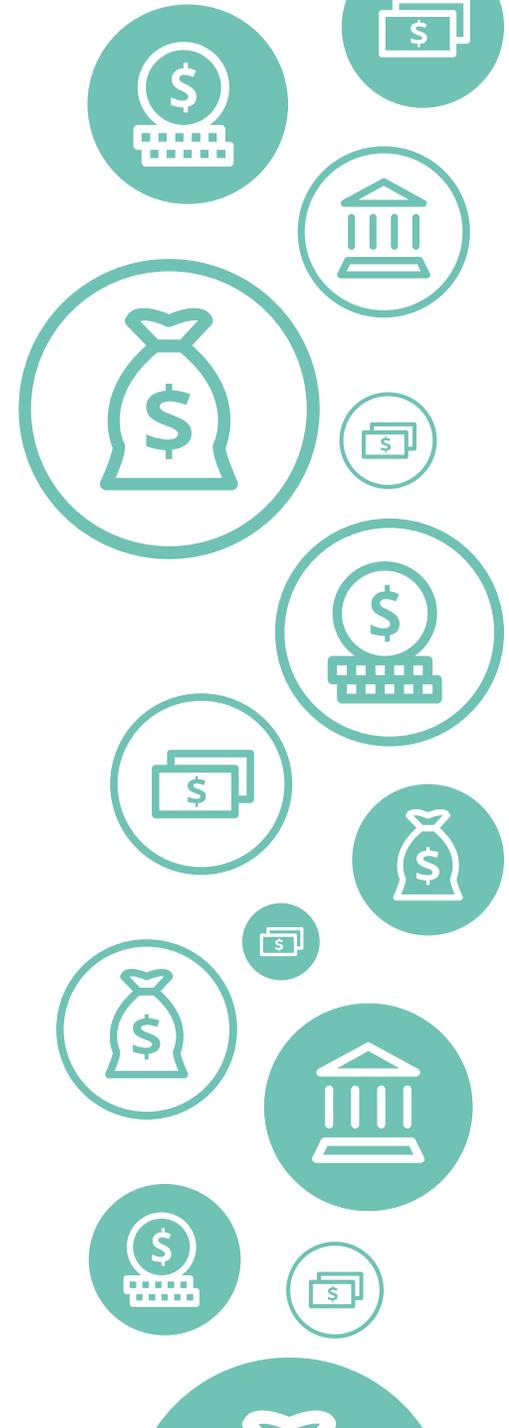
State & Local Sales & Use Tax Trends

#1 Item Identified in Tax Due Diligence Reviews

Remote State Sales Tax Collections

“Amazon Law” or “Click Through” nexus

- Enacted/proposed by more than 15 states
- Quill Corp v. North Dakota (1992) – Commerce Clause?



State & Local Tax Trends

Voluntary Disclosure Agreements (“VDA”)

- Usually waivers of penalties and/or interest
- Starts the clock for the statute of limitations
- Be on the lookout for Amnesty programs (i.e. Pennsylvania – deadline 19 June)
- Financial Statement benefit – Release FAS 5 Reserve



Questions?





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