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Final/temporary regulations address treatment of certain interests in corporations as stock or indebtedness

On October 13, 2016, the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") released the final and temporary regulations under section 385 of the Internal Revenue Code[1] (the "385 Regulations") that (i) establish threshold documentation requirements that ordinarily must be satisfied in order for certain related-party interests in a corporation to be treated as indebtedness for U.S federal income tax, and (ii) treat as stock certain related-party interests that otherwise would be treated as indebtedness for U.S federal income tax purposes.[2] Although the 385 Regulations were released on October 13, 2016, the published date of the 385 Regulations was October 21, 2016, for determining when various effective dates described below begin to apply to taxpayers.

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[1] Unless otherwise indicated, all "section" references are to the Internal Revenue Code of 1986, as amended (the "Code"), and all "Treas. Reg. §" references are to the Department of Treasury regulations (the "Treasury Regulations") promulgated thereunder.
[2] TD 9790.

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Scope

The 385 Regulations follow the issuance of, and are *significantly narrower* in scope than, the proposed regulations issued on April 4, 2016, under section 385 (the "Proposed Regulations"). The 385 Regulations can apply only to debt instruments issued by a domestic corporation to certain related persons. More specifically, the 385 Regulations apply to debt instruments that are: (i) issued by a "covered member"[3] and (ii) held by a member of the domestic corporation's "expanded group"[4]; provided however, that the 385 Regulations generally do not apply to a debt instrument if the holder is a member of the consolidated group to which the issuer belongs.

In addition to the exclusion of debt instruments held by a consolidated group member, the 385 Regulations provide an exclusion for debt instruments issued by foreign issuers, S corporations, regulated investment companies ("RICs") and real estate investment trusts ("REITs"). The 385 Regulations reserve on all aspects of their application to foreign issuers, including controlled foreign corporations ("CFCs"). However, the preamble to the 385 Regulations (the "Preamble") indicates that any guidance that may be subsequently issued, including with respect to foreign issuers, will apply prospectively only. Because the 385 Regulations reserve on all aspects of their application to foreign issuers, the rules do not currently address, for example, the financing of a foreign-parented group's US branch operations.

Bifurcation Rule Eliminated

Unlike the Proposed Regulations, the 385 Regulations do not include a general bifurcation rule, which would have allowed the IRS to treat a single debt instrument as part debt and part equity. The Preamble indicates that the Treasury and IRS will continue to study this issue. Purported debt instruments are still subject to bifurcation through the application of the recharacterization rules contained in Treas. Reg. § 1.385-3.

Documentation Rules

Treas. Reg. § 1.385-2 (the "Documentation Rules") imposes documentation requirements on certain related-party debt instruments as a prerequisite to treating such instruments as "debt" for US federal income tax purposes. The rules require written documentation of the following four indebtedness factors (the "Indebtedness Factors"):[5]

(i) The issuer's unconditional obligation to pay a sum certain,
(ii) The holder's rights as a creditor,
(iii) The issuer's ability to repay the obligation, and
(iv) The issuer's and holder's actions evidencing a debtor-creditor relationship, such as payments of interest or principal and actions taken on default.

With respect to credit facilities, revolvers, and omnibus, master arrangements, the Documentation Rules provide special rules to satisfy Indebtedness Factors (i) through (iv).

As compared to the Proposed Regulations, the 385 Regulations incorporate the following signficant changes:

- Extension of period required for "timely preparation": The 385 Regulations eliminate the Proposed Regulations' 30-day / 120-day timely preparation requirements. Instead, the documentation and financial analysis is considered "timely prepared" if it is prepared by the time the issuer's US federal income tax return is due (taking into account all applicable extensions), with respect to the relevant preparation dates.
- Rebuttable presumption based on compliance with documentation requirements: The 385 Regulations provide that, if an expanded group is otherwise "highly" compliant with the documentation requirements, then a rebuttable presumption in favor of stock treatment, rather than the *per se* recharacterization as stock, applies in the event of a documentation failure with respect to a purported debt instrument.
- Relaxed credit analysis: The 385 Regulations generally provide that an annual credit analysis may be used to support an issuer's ability to repay multiple debt instruments, rather than requiring a separate credit analysis

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[3] A "covered member" is currently defined to mean a domestic corporation or a disregarded entity of a covered member.
[4] The "expanded group" generally includes all corporations connected to a common parent that owns, directly or indirectly, 80% of the vote or value of each such corporation.
[5] Treas. Reg. §1.385-2(c)(2)(i) through (iv)

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for each debt issuance. Additional documentation is required if the issuer suffers a "material event". The rules also provide that the analysis of a borrower's ability to repay can take into account the issuer's ability to refinance.

- Notional cash pooling arrangements potentially in scope: The 385 Regulations provide that the written documentation requirements for the Indebtedness Factors that are otherwise applicable to credit facilities, revolvers, omnibus, master and cash pooling arrangements are also applicable to notional cash pooling arrangements, if such arrangements would be treated as debt issued between expanded group members.
- Trade payables may be covered by master agreements: The 385 Regulations clarify that trade payables are potentially within the scope of then Documentation Rules and that master agreements can be used to satisfy the written documentation requirements for trade payables.
- Treatment of disregarded entities: Unlike the Proposed Regulations, the 385 Regulations provide that if a debt instrument issued by a disregarded entity ("DRE") is recharacterized as equity due to failure to satisfy the Documentation Rules, then such debt will be treated as equity in the covered member that owns the issuing DRE. In other words, failing the Documentation Rules will not spring a DRE into a partnership.
- Exclusion of debt instruments issued by controlled partnerships: The 385 Regulations exclude debt instruments issued by controlled partnerships (but not debt instruments held by controlled partnerships) from the Documentation Rules, unless issued with a principal purpose of avoiding the application of the Documentation Rules.
- Delayed implementation: The Documentation Rules under the 385 Regulations apply only to debt instruments issued on or after January 1, 2018.

As a general matter, the 385 Regulations are less strict and more administrable than the Proposed Regulations. Similar to the Proposed Regulations, however, it is unclear how a cash pool header that takes on deposits would evidence its ability to repay. Further, while the 385 Regulations do not automatically disregard notional cash pooling arrangements as conduits, the reference to such arrangements suggests that the government will pay more attention to them in the future; accordingly, taxpayers should reconsider the documentation and operation of their notional cash pooling arrangements. Finally, despite the delayed implementation date and the narrower scope, taxpayers should consider preparing written documentation of the Indebtedness Factors for debt instruments issued prior to January 1, 2018, including debt instruments outside of the scope, such as fore foreign issuers, under general US federal income tax principles.

Debt Recast Rules

Treas. Reg. § 1.385-3 and Temporary Treas. Reg. § 1.385-3T (together, the "Debt Recast Rules") generally adopt the following operative rules of the Proposed Regulations in targeting debt instruments issued by a domestic corporation to an expanded group member in connection with distributions and certain acquisitions of expanded group stock from other members of the expanded group.

- A "General Rule" that applies if a domestic corporation distributes a debt instrument, or issues a debt instrument as consideration to acquire expanded group stock, or issues a debt instrument as boot that is received by an expanded group member in an asset reorganization; and
- A "Funding Rule" that generally recharacterizes certain debt as equity if a domestic corporation distributes property other than debt, acquires stock for property other than debt, or issues boot other than debt in an asset reorganization, if the domestic corporation has issued a debt instrument within a 36-month period before or after one of the foregoing transactions, or the debt was otherwise issued with a principal purpose of funding one of the foregoing transactions.

As compared to the Proposed Regulations, the 385 Regulations incorporate the following significant modifications and changes:

- Certain debt instruments excluded: The following debt instruments are excluded from the Debt Recast Rules:
    - Debt instruments issued before April 5, 2016,
    - Debt instruments issued by a regulated financial or insurance company, in each case as defined under the 385 Regulations,
    - Certain debt instruments issued by a domestic corporation to, or acquired by, a dealer in securities,
    - Certain "qualified short-term debt instruments" including the following: (i) short-term funding arrangements meeting one or the other (but not both) of the following: a current assets or 270-day test; (ii) ordinary course loans issued to acquire property other than money in the ordinary course of

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the issuer's business and reasonably expected to be repaid within 120 days; (iii) certain interest free loans where no interest is charged, imputed, or required to be charged and that does not have original issue discount (within the meaning of section 1273); and, (iv) certain deposits received by a "qualified cash pool header".

- Subsidiary stock exception broadened: The 385 Regulations retain and broaden the subsidiary stock exception in the Proposed Regulations to cover not only acquisitions of expanded group stock by issuance, but also acquisitions of expanded group stock from other members of the expanded group, in each case so long as the acquirer controls (meaning, direct or indirect ownership of 50% of combined voting power and value of the corporation under section 958(a)) the issuer or seller immediately after the acquisition.
- Earnings and profits ("E&P") exception: The E&P exception has been retained and continues to apply by reducing the amount of debt reclassified as stock based on the order in which the prohibited transactions occur. However, the exception has been broadened to include not only current E&P but also E&P that were accumulated by the issuer (while it was a member of the same expanded group) in taxable years ending on or after April 5, 2016. The exception provides several limitations and anti-avoidance provisions, including, but not limited to, only E&P accumulated by the domestic issuing corporation while it continued to have the same expanded group parent may be taken into consideration.
    - Because the E&P exception is limited to only those E&P that were accumulated by the domestic corporation while it continued to have the same expanded group parent, taxpayers should consider whether the exception applies to acquisition indebtedness incurred by a domestic target corporation.
- "Net equity" contribution exception: The 385 Regulations include a new exception for "net equity" contributions, where contributions of certain property to a corporation in exchange for stock of the transferee corporation within a specified time frame may be applied to reduce the amount of prohibited transactions undertaken by the transferee corporation.
- $50 million exception: Issuers can exclude the first $50 million of indebtedness that otherwise would be recharacterized under the Debt Recast Rules (the "Threshold Exception").
- Equity compensation exception: The 385 Regulations provide an exception for the acquisition of stock delivered to individuals that are employees, directors, and independent contractors as consideration for the provision of services.
- Treatment of controlled partnerships: For purposes of the General and Funding Rules, the 385 Regulations adopt an aggregate approach to controlled partnerships. If there is an event that would otherwise result in the treatment of a controlled partnership's debt instrument as equity, in lieu of recharacterizing the debt instrument as stock, the expanded group member that holds the debt instrument is deemed to contribute its receivable from the controlled partnership to the expanded group partner that undertook the distribution or acquisition in exchange for stock in that expanded group partner (but only if the expanded group partner is otherwise a covered member). This is known as the "deemed conduit approach."
- Other new exceptions: The 385 Regulations also incorporate a number of new exceptions, such as (i) deemed distributions or acquisitions resulting from transfer pricing adjustments, and (ii) an exception to address the "cascading problem" by exempting acquisitions of expanded group stock resulting from the application of the rules as being treated as giving rise to additional prohibited transactions that could cause the 385 Regulations to apply again.

Similar to the Proposed Regulations, under Temporary Treas. Reg. § 1.385-4T (the "Consolidated Group Rules"), members of a consolidated group are generally treated as one corporation for purposes of applying the Debt Recast Rules.

Effective Dates

The general provisions, Documentation Rules, and Consolidated Group Rules are effective and apply to taxable years ending on or after the date that is 90 days after the date the 385 Regulations were published in the Federal Register (*i.e.*, January 19, 2017). The Documentation Rules apply only to debt instruments issued on after January 1, 2018. Subject to certain transition rules, the Debt Recast Rules generally applies 90 days after the date on which the 385 Regulations were published in the Federal Register (*i.e.*, January 19, 2017). For debt instruments issued after April 4, 2016, but before 90 days after the 385 Regulations are published (*i.e.*, January 19, 2017), and where the 385 Regulations would have applied to recharacterize them as stock during this period, the debt instruments will not be recharacterized as stock until the 91st day after the date the 385 Regulations were published in the Federal Register (*i.e.*, January 20, 2017).

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Taxpayers can elect to apply the Proposed Regulations in lieu of the 385 Regulations to all debt instruments issued by specific issuers (and members of its expanded group that are domestic corporations) during the period from April 4, 2016 to October 13, 2016. The option is solely for purposes of determining if a debt instrument is treated as stock and must be consistently applied by the taxpayer.

Conclusion and Observations

Compared to the Proposed Regulations, the 385 Regulations appear to more precisely target inbound earnings stripping transactions. However, at the same time, the 385 Regulations can apply to loans issued by a domestic corporation to a CFC (*i.e.* section 956 loans) and loans between highly-related but non-consolidated domestic corporations. The 385 Regulations can considerably affect repatriation planning, reduce or eliminate US interest deductions and have other significant US federal income tax (and potentially, US state income tax) consequences. The 385 Regulations should be evaluated prior to entering into any related-party lending transactions.

For additional information, please refer to the following:

- United States Tax Alert, October 14, 2016, *Final/Temporary Regulations Address Treatment of Certain Interests in Corporations as Stock or Indebtedness*
  URL: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-alert-new-section-385-regulations.pdf

- Dbriefs Webcast: Section 385 Regulations: What they mean for your company
  October 21 | 11:00 a.m. ET
  URL: https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/october/2016/dbriefs-section-385-regulations-what-they-mean-for-your-company.html?id=us:2em:3na:usic:awa:tax:112116

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Transferring Intellectual Property to a Foreign Related Party? Be on the Lookout for Section 1239

For inbound taxpayers looking to extract valuable intellectual property from the United States and move it to an affiliated foreign entity, controlling the US federal income tax cost of such a transaction is often times a significant priority. In many instances, the gain recognized on the disposition of intellectual property can be capital in nature or qualify for capital treatment under Section 1231. Therefore, what better way to mitigate the US tax cost then by utilizing some expiring capital losses from an investment gone sour? Not so fast. Before pushing forward with that transfer, taxpayers should take a long hard look at Section 1239.

What is Section 1239?

Section 1239(a) states that "in the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, of a character which is subject to the allowance for depreciation provided in section 167." Thus, Section 1239 serves as a recharacterization provision, and generally only applies when an item of income is otherwise treated as capital for US income tax purposes.

In this context, the term "related parties" means a person and all entities which are controlled entities with respect to such person.[6] Section 1239(c)(1) defines the term "controlled entity" as meaning, with respect to any person, a corporation more than 50 percent of the value of the outstanding stock of which is owned (directly or indirectly) by or for such person. Additionally, in determining whether an entity is a "controlled entity," certain constructive ownership

[6] Section 1239(b)(1).

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provisions under Section 267 apply,[7] including treating two corporations which are members of the same controlled group as related parties for purposes of Section 1239.[8]

Unlike Section 1245, Section 1239 does not look to the treatment of the property in the hands of the transferor (*i.e.*, the seller), but rather inquires whether such property would be subject to depreciation in the hands of the transferee (*i.e.*, the purchaser). Section 1239 operates to recharacterize gain on the disposition of property if that property is considered depreciable property to which Section 167 applies in the hands of the transferee. In determining the assets to which the rule applies, Section 1239 uses identical wording to both Section 1221(a)(2) and Section 197(f)(7) with respect to defining depreciable property, treating any amortizable Section 197 intangible as property which is of a character subject to the allowance for depreciation provided in Section 167. Therefore, the application of those particular Sections to a taxpayer's assets should be illustrative of the types of property to which Section 1239 also applies. Accordingly, if a transferee acquires intangible property from a transferor and the transferee is not permitted to depreciate the acquired intangible property pursuant to Section 167, then Section 1239 should not apply to characterize the gain as ordinary. It is therefore imperative that the transferor and transferee understand the type of intellectual property that is being transferred and whether such property may be subject to the allowance for depreciation in the hands of the transferor within the meaning of Section 1239.

Determining Whether Intellectual Property is Subject to the Allowance for Depreciation?

Once a commercial decision has been made to transfer intellectual property from a US subsidiary, a determination must be made as to whether the property is subject to the allowance for depreciation in the hands of the transferee.

Section 167 generally provides that a reasonable allowance for depreciation is permitted for the exhaustion, wear and tear, or obsolescence of property used in a trade or business.[9] The corresponding regulations indicate that, in general, an intangible asset may be the subject of a depreciation allowance where the intangible asset is used in a trade or business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy.[10] An intangible asset, the useful life of which is not limited, is generally not subject to the allowance for depreciation.[11]

Intangible assets may, however, be treated as subject to the allowance for depreciation under Section 167 if specifically provided for by another Code Section. Section 197 provides for amortization of goodwill and certain other intangible assets, which are not otherwise depreciable under Section 167, generally to the extent such assets were acquired after August 10, 1993 (or after July 25, 1991, if a valid retroactive election under Treas. Reg. § 1.197-1T has been made).[12] Thus, Section 197 generally allows a taxpayer to deduct amortization with respect to so-called "amortizable Section 197 intangibles" acquired by the taxpayer and which are held in connection with the conduct of a trade or business or an activity described in Section 212 (*i.e.*, production of income activities).[13] An "amortizable Section 197 intangible" includes goodwill, going concern, patents, copyrights, customer and supplier based intangibles, franchises, trademarks, or trade names.[14] Section 197(e) and the regulations thereunder contain certain exceptions to the definition of a Section 197 intangible including certain types of computer software and certain interests in patents and copyrights not acquired as part of a purchase of a trade or business.[15] Nevertheless, such assets may be depreciable under Treas. Reg. §1.167(a)-14, and thus still subject to the allowance for depreciation.

Prior to the enactment of Section 197, goodwill and going concern value were considered non-amortizable capital assets. Congress was concerned that, post August 10, 1993, a taxpayer would sell goodwill or going concern value intangibles to related persons solely for the purpose of converting a non-amortizable intangible asset to an amortizable

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[7] Section 267(b)(3), (10), (11), or (12).
[8] Section 267(b)(3).
[9] Section 167(a) and Treas. Reg. §1.167(a)-1(a).
[10] Treas. Reg. 1.167(a)-3(a).
[11] *Id.*
[12] Id. and Treas. Reg. §1.197-2(l)(1).
[13] Section 197(a) and (c)(1).
[14] See Section 197(d)(1).
[15] See Treas. Reg. §1.197-2(c)(4) and (7).

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Section 197 intangible asset and, thus, the so-called "anti-churning" provisions were included as part of the statute under Section 197(f)(9).[16]

Under the anti-churning provisions, goodwill, going concern value and any other intangible asset (including trademarks and trade names) that would not have been amortizable but for the provisions of Section 197, are not treated as amortizable Section 197 intangible assets if acquired after August 10, 1993 and either:[17]

1. The intangible asset was held or used at any time on or after July 25, 1991 and before August 10, 1993 by the taxpayer or a related party;
2. The intangible asset was acquired from a person that held the assets at any time on or after July 25, 1991 and on or before August 10, 1993 and as part of the transaction the user of the intangible does not change; or
3. The taxpayer grants a right to use the intangible asset to a person (or a related person) who held or used the intangible asset at any time on or after July 25, 1991 and on or before August 10, 1993.

For purposes of the anti-churning rules, a related person is a person that is considered related under the rules contained in Section 267(b) and Section 707(b)(1) (using a 20 percent test instead of the 50 percent test), or businesses under common control within the meaning of Section 41(f)(1)(A) or (B).[18]

Assessing the Impact of Section 1239

Section 1239 results in a potentially harsh outcome to unsuspecting taxpayers with available capital losses. Therefore, in undertaking an analysis of any proposed intercompany intellectual property transfer, it is imperative that the taxpayer undertakes a thorough inventory and characterization of each intangible asset being transferred. In doing this analysis the taxpayer should understand each separate intangible asset's tax history, including the period during which such asset was owned by the transferor and any predecessor from whom the transferor acquired such asset in a nontaxable exchange. While this may seem like a daunting task, it is necessary in order to determine if the asset being transferred is subject to the allowance for depreciation and whether the anti-churning rules may apply to the transferee to make the asset non-depreciable in the transferee's hands. In many instances the results of this analysis may lead to those expiring capital loss carryforwards potentially remaining unused and unavailable to offset the capital gain recognized on the assets transferred to an affiliated foreign entity.

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The Dark Side of Executive Travel: Exposure to US Taxable Presence

In today's global marketplace, where cross-border mergers, acquisitions, and business consolidations have become commonplace, the location of key management functions within multinational corporations is in an almost continuous state of flux. In order to stay competitive in the constantly changing global business landscape, multinational corporations are forced to transcend geographic boundaries when it comes to the activities of their executive personnel. Of particular importance to inbound clients, senior management, directors, and officers may be based or spend a significant amount of time in the United States in order to effectively oversee business operations and achieve desired synergies.

Whether this type of cross-border activity by senior executives and employees creates a taxable presence in the United States for foreign companies may come under increased scrutiny by the US Internal Revenue Service ("IRS").[19] While the global marketplace has evolved drastically over the past several decades, the rules on what constitutes a

[16] See also Treas. Reg. §1.197-2(h).
[17] Section 197(f)(9)(A)(i)-(iii); Treas. Reg. § 1.197-2(h)(2).
[18] Section 197(f)(9)(C); Treas. Reg. § 1.197-2(h)(6).
[19] *See e.g.*, Internal Revenue Service, LB&I International Practice Service Transaction Unit, *Creation of a Permanent Establishment (PE) through the Activities of Seconded Employees in the United States*, Vol. 16.6.2 (Sept. 3, 2014).

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taxable presence in the United States under US federal income tax law, as well as under most US income tax treaties, have not significantly changed. Not surprisingly, applying antiquated rules to the new global economy can lead to unexpected results. It may then come as a surprise that, in the context of global management, US federal income tax law may, in some cases, provide more of a safeguard from triggering a taxable presence in the United States than the concept of permanent establishment ("PE") under an applicable US income tax treaty.[20]

Relevant Law

For a foreign corporation to be subject to the US corporate income tax, it is sometimes a prerequisite that the corporation be engaged in trade or business in the United States (a "US trade or business" or "USTB"). But, if the corporation is a resident of a country with which the United States has entered into an income tax treaty, it may still be possible that the corporate income tax is eliminated if the corporation has no PE in the United States.

Whether a foreign corporation has a USTB is determined by taking into account the activities of its agents in the United States. Though there is no codified definition of what activities give rise to a USTB, a corporation that engages in profit-oriented activities that are "considerable, continuous, and regular"[21] in the United States may be deemed to have a USTB whether or not it has an office or other fixed place of business in the United States. In order to rise to the level of a USTB, profit-oriented activity generally must be more than simply ministerial, clerical or passive in nature,[22] and, generally, must be recurring, as opposed to isolated, activity.[23]

The definition of a PE is commonly understood to be narrower in scope than that of a USTB. Under a US treaty that conforms to the long-standing Article 5 provisions of US and OECD Model treaties,[24] Article 5(1) generally defines a PE as a "fixed place of business through which the business of an enterprise is wholly or partly carried on." Thus, an enterprise of a treaty country[25] generally creates a US PE by having a fixed place of business in the United States available to it for purposes of conducting its business activities.[26] Article 5(2) of such a treaty would provide that "[t]he term 'permanent establishment' includes especially…a place of management; …." It is possible, therefore, that a PE might exist at a fixed place of business where corporate management is located. Even in the absence of such a fixed place of business, paragraphs 5 and 6 of Article 5 of such a treaty might cause the US activities of an agent of the corporation to constitute a US PE of the corporation, but only if the agent has and habitually exercises, in the United States, an authority to conclude contracts in the name of the corporation generally, and not if the agent is of independent status, and acting in the ordinary course of his business as an agent.

Three Common Scenarios Raising Management PE Issues

Dual Role Personnel: It is increasingly common for one executive to manage both US and non-US business operations. For example, a foreign multinational expanding its distribution into the United States may appoint its head of global marketing to act as CEO of the US subsidiary, with 50 percent of the executive's time being spent on global branding for the foreign parent and the remaining 50 percent spent on business operations of the US subsidiary, both roles being performed, in part, at the offices of the US subsidiary.

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[20] The definition of this term generally takes up an entire article of any US income tax treaty (typically, Article 5).
[21] *See, e.g.*, *de Amodio v. Commr.*, 34 T.C. 894 (1960), *aff'd*, 299 F.2d 623 (3d Cir. 1962).
[22] *E.g.*, mere management and collection of investment income generally would not give rise to a USTB. *See e.g., Scottish American Investment Co. v. Commr*, 12 T.C. 49 (1949).
[23] *But see* Rev. Rul. 58-63, 1958-1 C.B. 624. Additional analysis must be performed by the foreign executives with respect to individual taxation not addressed here.
[24] Following the completion of the 2015 final reports on the G20/OECD "BEPS" Project, new model provisions were proposed for the PE definition in the OECD Model, and the US Model was revised (although its PE definition was not revised to accord with the proposed PE definition changes to the OECD Model). But, the newest US treaties date from before 2011, so post-2011 developments in model treaties are generally not all that relevant to the design of the language in the US treaties now in force.
[25] By "enterprise of" a treaty country (or "Contracting State," the technical treaty term for treaty country) is meant an enterprise (generally, a trade or business) carried on by a resident of a treaty country.
[26] An exception to this general principle applies to certain activities listed in Article 5(4) of such a treaty, such as stock warehousing, or certain activities "preparatory or auxiliary" to the enterprise's business.

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There may be a high risk that the foreign multinational has a US PE in this scenario. The availability to the executive of an office in the United States risks creating a "fixed place of business" US PE and a "place of management" US PE due to the executive's global marketing duties, executed in part while at the US subsidiary's offices. There also could be agency US PE risk if the executive engages in more than mere marketing activities, and solicits or negotiates contracts on behalf of the foreign parent while physically present in the United States.

However, the fact that a foreign corporation's activity is carried on through a fixed place in the United States does not mean that it is a *business* activity of the foreign corporation. Example 2 under Treas. Reg. § 1.864-3(b) provides that certain limited activities carried out by a foreign executive in the United States should not give rise to a USTB. In that example, the CEO of a foreign holding company also acts as the CEO of one of the company's US subsidiaries and "spends a substantial portion of the taxable year" in the United States both supervising the foreign parent company's investment in its operating subsidiaries and acting as CEO of the US subsidiary. The example states that the foreign parent "is not considered to be engaged in a [USTB] during the taxable year by reason of the activities carried on in the United States by its chief executive officer in the supervision of its investment in its operating subsidiary corporations." While performing ownership-type functions with respect to a subsidiary is not a "business" activity, the example does not address other types of executive or management activities, such as the foreign parent's marketing activities in our scenario.

Periodic Management Visits: Arguably one of the most common situations involving cross-border executive travel is management from a foreign company periodically visiting its US subsidiary to perform stewardship and high-level operational support activities for the worldwide group (*e.g.*, general oversight and training) and/or business administration (*e.g.*, regulatory requirements and human resources). Visiting personnel is generally given plenary access to the offices of the US subsidiary as well as dedicated office space. While such executives are in the United States, they continue to perform operational and management duties on behalf of and for the benefit of the foreign parent.

Even though the foreign executives in this scenario may not create an agency PE since they are not soliciting or negotiating sales contracts, they might risk creating a "fixed place of business" PE or a "place of management" PE, if their presence is sufficiently sustained. Not only do the foreign executives have unfettered access to the US offices, but they also perform management activities critical to the foreign corporation's business operations that go well beyond mere "preparatory or auxiliary" activities.

Regional or Global Management: Another common fact pattern in an acquisition context involves US entities engaged in regional or global management. For example, a foreign parent wishing to expand into a new business line may acquire a US target and retain such target's US-based executive personnel to manage such business line on a global or regional basis. The executives are employed by the US company and provide strategic direction and management oversight of that business line's worldwide employees. The employees in this business line employed by non-US subsidiaries of the foreign parent report to the global or regional management in the United States and occasionally travel to the United States.

From a USTB standpoint, the question is whether Example 2 under Treas. Reg. § 1.864-3(b) shields the foreign parent and the non-US subsidiaries from having a USTB due to activities of the US regional or global management team. If not, the US regional or global management team might also create PE exposure for both the foreign parent and the non-US subsidiaries engaged in the same business line.

Minimizing Exposure

It is easy to see from the above examples why global executives present in or regularly traveling to the United States run the risk of triggering a USTB, or of creating a US PE. Often, such executives have access to the US offices of a US subsidiary and, in light of their management role in the foreign corporation, may have express contractual authority. Thus, non-US parented companies with senior management, directors, or officers spending significant amounts of time in the United States should take a closer look at the activities of global management, and may find it helpful to set up operating protocols limiting such activities in order to avoid inadvertently establishing a taxable presence in the United States.

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Private Wealth: 2017 Essential Tax and Wealth Planning Guide: Opening doors

The old adage, "If it's not broken, don't fix it," may apply to mechanical devices, but not to tax and wealth planning. The world is changing rapidly. Planning tools need to change accordingly, be refreshed regularly, be easy to access, and, most importantly, cultivate ongoing dialogue between you, your family members, and your tax advisers. More and more individuals and companies conduct business across borders around the world.

The 2017 Essential Tax and Wealth Planning Guide offers many valuable considerations to assist in your tax planning as these trends unfold. Review the full report and contact Julia Cloud for more information about Private Wealth.
URL: https://www2.deloitte.com/us/en/pages/tax/articles/tax-and-wealth-planning-guide.html?id=us:2em:3na:usic:awa:tax:112116
URL:
mailto:jucloud@deloitte.com?subject=RE:%20Private%20Wealth:%202017%20Essential%20Tax%20and%20Wealth%20Planning%20Guide

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Calendars to watch

Each edition, be sure to mark your calendars for some of the more important events (recent and upcoming) as well as tax developments making in impact on businesses investing into the United States.

Recent and Upcoming Activities

November 10 — **Dbriefs webcast archive:** Election 2016: What does it mean for tax policy?
Watch
URL: https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/november/2016/dbriefs-election-2016-what-does-it-mean-for-tax-policy.html?id=us:2em:3na:usic:awa:tax:112116

November 14 — **Dbriefs webcast archive:** Top state tax issues to consider before year end: What tax professionals should know
Watch
URL: https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/november/2016/dbriefs-top-state-tax-issues-to-consider-before-year-end-what-tax-professionals-should-know.html?id=us:2em:3na:usic:awa:tax:112116

November 15 — **Dbriefs webcast archive:** Research tax credit: Final regulations for software development activities
Watch
URL: https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/november/2016/dbriefs-research-tax-credit-final-regulations-for-software-development-activities.html?id=us:2em:3na:usic:awa:tax:112116

November 18 — **Dbriefs webcast archive:** Global indirect tax: Addressing the challenge of an expansive foot print with multiple technologies
Watch
URL: https://www2.deloitte.com/us/en/pages/dbriefs-webcasts/events/november/2016/dbriefs-global-indirect-tax-addressing-the-challenge-of-an-expansive-footprint-with-multiple-technologies.html?id=us:2em:3na:usic:awa:tax:112116

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