Inbound Tax

U.S. Inbound Corner

October 2014

In this issue:

Treasury releases inversion guidance

Fulfilling recent promises by Treasury Secretary Jacob "Jack" Lew, the Obama Administration released guidance late September 22 that Lew said "will make companies think twice" before undertaking a corporate inversion transaction.

The debate over inversions has featured heavily in tax policy discussions over the summer. Congressional Democrats introduced bills that would either change the threshold for an inversion to be respected or tighten the earnings stripping rules for inverted companies. Those bills gained little traction, and although Senate Finance Committee Chairman Ron Wyden, D-Ore., and Ranking Republican Orrin Hatch of Utah continue talks on crafting bipartisan legislation, members of Congress left Washington last week to campaign for the mid-term election without taking any action on the inversion issue. Meanwhile, Lew said that while the Administration preferred congressional action and supported a handful of Democratic legislative proposals, Treasury would address the economics of inversions through regulatory action if no legislation was forthcoming. (For prior coverage, see *Tax News & Views*, September 19, 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140919_1.html

Notice 2014-52

The guidance (Notice 2014-52) announces that Treasury and the IRS will issue regulations under several code sections to address what the Administration calls "tax avoidance transactions" that would not be possible absent an inversion. A Treasury fact sheet accompanying the Notice states: "This action will significantly diminish the ability of inverted companies to escape US taxation. For some companies considering mergers, today's action will mean that inversions no longer make economic sense."
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140923_1suppA.pdf
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140923_1suppB.pdf

The regulations will be intended to increase the effective tax rate for foreign acquirers of US targets and tighten the anti-inversion rules of section 7874. According to the Notice, the regulations generally would be effective for inversion transactions completed on or after September 22, 2014. A more detailed analysis of the Notice is available in an International Tax Alert from Deloitte Tax LLP.
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-unitedstates-230914.pdf?id=us:em:na:tnv:eng:tax:092314

Hill reaction

Initial reactions from the top taxwriters on Capitol Hill were mixed, but all stressed the need for congressional action on comprehensive tax reform. Wyden said Treasury's move reinforced the urgency of action, "but only Congress has the full range of tools to address both the immediate problem and ensure US businesses continue to be competitive in the global economy." Hatch echoed Wyden's comments about the need for tax reform and said he would study the Administration's proposal. However, he reiterated his stance on the principles that should guide Congress's approach to inversions. (For details on prior statements from Senators Wyden and Hatch, see *Tax News & Views*, Vol. 15, No. 31, September 12, 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140912_1.html

House Ways and Means Chairman Dave Camp, R-Mich., was more critical and called on the Administration to get serious about tax reform. "A few campaign style speeches and stopgap measures from Treasury won't [address inversions] – it hasn't worked in the past, and even Secretary Lew admits the only real solution is tax reform. I fear this Administration is only interested in doing the bare minimum – just enough to say they care," Camp said.

— Jon Almeras (Washington, DC)
Manager
Deloitte Tax LLP
jalmeras@deloitte.com

Jeffrey O'Donnell (Washington, DC)
Principal
Deloitte Tax LLP
jodonnell@deloitte.com

Technology Considerations of Country-by-Country Reporting

Among the priorities of the OECD's global tax reform project, known as base erosion and profit shifting (BEPS) project, "transfer pricing documentation requirements should be less burdensome and more targeted." Toward this stated goal, the OECD recently published a finalized Chapter V of the OECD Guidelines. With their significant new reporting requirements, the guidelines will instead more likely increase the compliance burden on multinational enterprises (MNEs) in the effort to create an environment of increased transparency. The costs of compliance, however, will vary depending on the technological capabilities the MNEs already have in place.

The final Chapter V proposes that jurisdictions require MNEs to prepare a yearly document, to share with tax authorities around the world, that reports their global allocation of income, economic activity, and taxes paid on a country-by-country basis. Such requirements may necessitate an undertaking by MNEs of complex data collection initiatives when there is not one optimal source for such a large data set. However, the full impact of the additional requirements the new Chapter V imposes will not be understood until January 2015, when the OECD releases additional guidance on implementation issues, including timing. As part of its work on the implementation of the new rules, the OECD is expected to provide guidance to countries on effective dates, including the phasing in of the requirements. As such, the way and timing in which these new requirements will be implemented in each country will likely differ. Given the comments made by the various representatives to the OECD, it is reasonable to believe that certain European countries and emerging economies may implement and enforce these rules with particular vigor.

Through use of ERP systems and additional software, with varying levels of completeness and integration, most MNEs have so far managed centralized reporting requirements. However, as the country-by-country template presents an entirely new set of reporting requirements, MNEs may not have adequate systems in place to automatically produce the requisite data points. While the information will be difficult for many companies to obtain, the source of the difficulty will vary substantially by MNE. For example, MNEs may not have singular global systems in place, due to lack of investment in systems integration or rapid acquisitions of multiple companies. MNEs with a single ERP system will face different issues than ones with multiple ERP systems. The specific configuration of the ERP system will affect the treatment of intercompany eliminations. Differences in the levels of consolidation and reporting will play a significant role in the amount of effort required to identify the appropriate data. Some companies may operate largely in countries that require local financials while others may not. Some data may lie outside of ERP systems and data extracted from multiple systems may need to be manually integrated. Reporting structures may be decentralized and the parent company's tax department may not have access to local systems in foreign countries. All these considerations may pose new technology challenges and require tax departments to work with information technology personnel in identifying and developing a road map to address country-by-country reporting challenges.

Given the nature of the new requirements, it is anticipated that the country-by-country template will be prepared at the parent company level. As such, for US inbound companies, foreign parents will be looking to capture their information for the country-by-country template based on the data accessible at the parent company level. Should such data not be sufficient for the country-by-country reporting purposes, the involvement of the US inbound company's personnel will likely be required to help fill the gaps and provide the requirement information. It will also be important to have a good understanding of the information captured for the US inbound company in the country-by-country template by the foreign parent to determine its reliability and consistency with local US filings. In the event that the country-by-country reporting is required in the US, the data presented for the US entities should closely align with the local financial statements and tax filings.

The key to implementing country-by-country reporting solutions for MNEs' tax departments is to facilitate a holistic approach for understanding the data requirements. The tax department and the entire enterprise need to work together to design solutions that address both compliance and business needs. New systems or applications do not necessarily need to be added. Features and functionality of the existing financial reporting systems may potentially be improved to obtain the information required to complete a country-by-country reporting template. For example, US companies may be able to somewhat leverage the information that is currently captured in Forms 5471 and 8858 for purposes of country-by-country reporting, though a number of adjustments will likely be required. Non-US companies, however, may likely have less to leverage and need longer lead-times to comply with the country-by-country requirements. However, if a new technology needs to be implemented, there are a number of options that may be currently available to MNEs.

The least costly, complex, and time consuming application for collecting data involves enhancing spreadsheets. Tailored and enhanced spreadsheets, possibly using macros, could be created to manage data collection. In such systems, however, there is a limited ability to perform data modelling.

Solutions consisting of data warehouses with custom reporting and analytics may be more costly than spreadsheet-based solutions, but reporting and analytics capabilities would likely be more advanced and flexible. Such applications could produce bespoke and customizable reports relevant to specific stakeholders.

A dedicated transfer pricing solution may be the most costly option, but it allows for a broad-based response to the increasingly complex audit environment. Such a solution goes beyond producing the information needed for the country-by-country template. From the central tax department, reports and real-time visualizations could be used for global transfer pricing planning and active management of profit margins throughout the global organization. The solution would provide automation to manage price changes and upload this information back to the financial systems.

The advent of country-by-country reporting signifies a potential opportunity for MNEs to update tax-related technology as part of a global compliance strategy to drive value for the MNE. Enhancing technology to comply with the updated compliance landscape is not just an additional regulatory burden, it presents a potential opportunity to proactively manage the compliance process to improve global processes, defensibility, and planning. Rather than be reactive to increasing compliance burdens, MNEs can be proactive and utilize available resources to create strategic value from the tax department.

— Boris Nemirov (New York)
Principal
Deloitte Tax LLP
bnemirov@deloitte.com

New Regulations Open the Door to New Opportunities Under Section 336(e)

Inbound investors should be aware of expanded opportunities to obtain a step up in the US tax basis in assets with a stock acquisition. Historically, there was a limited opportunity to obtain a tax basis in assets equal to fair market value (i.e., a tax basis step-up) in the acquisition of US shares. That opportunity generally was available to US corporate purchasers of stock through an Internal Revenue Code section 338(h)(10) election. Recently finalized Treasury regulations under section 336(e) have created a new opportunity for inbound investors to qualify for a similar election in expanded scenarios (e.g., joint venture). This article discusses the importance of such elections, and some key differences between section 338(h)(10) and section 336(e) elections.

Asset v. Stock Acquisitions

The opportunity to increase tax basis can yield cash flow benefits in situations where increased depreciation and amortization deductions can offset taxable income. One virtue of an asset acquisition (as opposed to a stock acquisition) is the resulting fair market value tax basis in assets, which generally results in a step-up in tax basis, for the purchaser.

However, while an asset acquisition often creates value in terms of tax basis, the contractual nuances to such a transaction can be costly and time-consuming for non-tax reasons. As such, a stock purchase is often viewed as the less complicated approach to acquiring a company, even though it means the buyer (i) acquires the corporation which holds its assets with their historic (i.e., carryover) tax bases and (ii) inherits historic tax liabilities.

Fortunately, some benefits of both forms of acquisitions are available where certain tax elections are made to treat the transaction as an asset acquisition solely for income tax purposes. This effectively opens the door to the best of both worlds: the tidiness of a stock acquisition with a fair market value tax basis in assets.

Historically, taxpayers had to rely exclusively on a section 338(h)(10) election in connection with a qualified stock purchase in order to obtain the benefit of an asset basis step up. Because of the section's requirements, the election was only available in a very narrow set of circumstances. Since May 15, 2013, however, final regulations made section 336(e) elections available for "qualified stock dispositions," opening the door to a new set of possibilities for both domestic and foreign purchasers.

Then and Now: Sections 338(h)(10) v. 336(e)

Whereas a section 338(h)(10) election only is available in the case of a single corporate purchaser of stock, the final section 336(e) regulations expand the scope of the section 336(e) election to many more circumstances. Under the final section 336(e) regulations, there can be multiple acquirers, and multiple transactions. A qualified stock disposition is not limited to stock sales and can include a taxable stock distribution. Furthermore, the identity of the purchaser is irrelevant, so long as the purchaser is not related to the seller and not a purchaser that would qualify for a section 338(h)(10) election. The following table summarizes these and other differences between the two elections:

Section 338(h)(10) election	Section 336(e) election
Joint seller and buyer election	Seller and target election by agreement
Election within 8.5 months	Election on tax return(s)
One corporate purchaser	*Any number of corporate or non-corporate acquirer(s) including domestic partnerships, individuals, foreign partnerships, foreign corporations, joint ventures, etc.*
Seller is a domestic corporation, a group of S corporation shareholders, or a consolidated or affiliated group; Target is a domestic C corporation or S corporation	Seller is a domestic C corporation; Target is a domestic C corporation or S corporation
12-month acquisition period	12-month acquisition period
Sale of 80% vote and value (excluding Section 1504(a)(4) stock)	Sales and/or taxable distributions totaling 80% vote and value (excluding Section 1504(a)(4) stock)
Related person restriction (Section 318(a) attribution)	Related person restriction (Section 318(a) attribution but not between partnerships with < 5% partners)
Not available if Seller or Target is foreign	Not available if Seller or Target is foreign

Opportunities Going Forward

In light of the final section 336(e) regulations, opportunities may now exist for certain inbound investors interested in investing through a joint venture to obtain a fair market value tax basis in assets. We encourage inbound investors to consider this opportunity when evaluating a transaction with a US entity. Interested parties should seek professional consultation to evaluate the possibility to file a section 338(h)(10) or section 336(e) election and obtain a fair market value tax basis in assets as well as the impact to the overall deal economics.

— Mark Schneider (Washington, DC)
Principal
Deloitte Tax LLP
markschneider@deloitte.com

James Watson (Chicago)
Partner
Deloitte Tax LLP
jamwatson@deloitte.com

Sean Duffley (Washington, DC)
Senior Manager
Deloitte Tax LLP
sduffley@deloitte.com

State & Local Incentives & Credits: Consideration for Inbound US Companies

The United States has been the world's biggest recipient of foreign direct investment since 2006.[1] Foreign companies continue to open new or expanded facilities in the US and provide additional capital to establish operations.

Some data points to consider are from a late-2013 report prepared by the Department of Commerce and the President's Council of Economic Advisers that showed significant foreign direct investment benefits to the US economy, including:

- In 2012, net US assets of foreign affiliates totaled $3.9 trillion.
  - Since 2006, foreign direct investment (FDI) inflows have totaled $1.5 trillion.
  - For 2012, FDI inflows totaled $166 billion.
- In 2011, value-added by majority-owned US affiliates of foreign companies accounted for 4.7 percent of total US private output. These affiliates:
  - Employed 5.6 million people in the United States, or 4.1 percent of private-sector employment.
  - Account for 9.6 percent of US private investment and 15.9 percent of US private research and development spending.[2]

Once the decision is made to invest in the US, these companies face the challenge of choosing the best location and finding qualified workers, two factors that are often affected at least in part by available tax credits and incentives (collectively, "incentives"). Adding to the complexity of investing in the US is the fact that incentives are offered primarily at the state and local level and not at the national level. This is a different process than that typically found in the rest of the world.

To an inbound US investor, the vast array of incentive programs and the necessary compliance required to monetize the related benefits can be daunting.

Therefore it is important for the foreign investor to understand which US incentives are most likely to be of enough importance to impact location decisions.

In order for the foreign investor to determine which US incentives have significant potential benefit, the first step is to prioritize what is of value to the investor's contemplated US operation.

Is the company a manufacturing, distribution, or service orientated operation? If it is a manufacturing operation, is it an industrial process (i.e. extensive use of raw materials, high utility usage) or a light manufacturing process (basic assembly)?

Clearly defining your operational priorities and functional attributes helps identify which incentives are likely to have a higher value and impact on your location decision.

---

[1] See, *New Report: Foreign Direct Investment In the United States*, prepared by the Department of Commerce and the President's Council of Economic Advisors (Oct. 31, 2013), available at http://www.commerce.gov/news/press-releases/2013/10/31/us-commerce-department-and-presidents-council-economic-advisors-relea.
[2] *Id.*

Most companies are interested in cash-equivalent incentives that lower up front capital outlays or ongoing operating costs. Examples include cash grants, subsidized real estate, and property tax abatements and exemptions. These incentives are easily quantified and generally, if properly secured, translate into bottom-line savings.

But inbound investors should not ignore the value of targeted local incentives programs, such as fast-track permitting, waiver of planning or permit fees, and employee recruiting support.

The third type of benefits to consider is state statutory tax credits. These credits can be applied to a company's state income tax liability. Statutory tax credits can include job credits for new employment, investment tax credits for qualified capital investments, training credits for employees, and others. Also, state statutory sales tax credits and exemptions can be available.

With the amount of investment involved in expanding in the US, it is not surprising that site selection, infrastructure assessments and labor studies require significant effort. Therefore it stands to reason that understanding and evaluating incentives should be no less significant. The variety of state, county and city incentives vary dramatically from state to state. Companies must understand the performance requirements, application deadlines and how the benefits can be utilized. Also understanding the company's obligations and commitments to fully realize the benefits are just as important as the benefits themselves.

States regularly revise their incentives. Recent more noteworthy changes include:

Arizona – In 2011 and 2012, Arizona underwent major changes to its economic development programs. It created several new economic development tools to support growth and expansion in the state. H.B. 2001 created a $25M Deal Closing Fund was created to be used in highly competitive situations when taxpayers are deciding between states to locate its project. The Fund is a performance based award that contains clawback provisions if the goals of the project are not met. The Quality Jobs Tax Credit was also created to be a state wide income tax credit of up to $3,000 per year for three years for each qualified employee the business hires. To be a qualified company, it must either in rural areas invest $1M and hire five (5) net new employees, or invest $5M and hire twenty-five (25) net new employees in metropolitan areas. Arizona also reauthorized its Job Training Program that supports the design and delivery of customized job training plans for employers hiring new employees or enhancing the skills and wages of existing employees. The Qualified Facility Credit established in 2012, provides a tax credit to promote the location and expansion of manufacturing facilities, including manufacturing-related research & development or headquarters facilities to encourage business investment in the state.

California – During the summer of 2013, California enacted legislation that phases out and replaces the California Enterprise Zone ("EZ") tax credits with a new economic development program comprised of a hiring tax credit, a statewide partial sales and use tax exemption for manufacturing and biotechnology equipment (including research & development equipment), and a discretionary incentives fund called the California Competes Tax Credit (CCTC) to provide tax credits for purposes of retaining existing and attracting new business activity throughout the state. The CCTC has $150 million in funding available for fiscal year 2014-2015 and $200 million available for fiscal year 2015-2016. In the initial round of CCTC funding awarded during fiscal year 2013-2014, a wide variety of localities and industries participated in the program, including Semiconductor R&D, ethanol/biofuel manufacturing, online retail warehouse & distribution, and aerospace, among others. It should be noted that while the former EZ tax credits have now been phased out, benefits may still be available for the open tax years prior to 2014.

New Jersey – On September 18, 2013, Governor Christie signed into law the Economic Opportunity Act of 2013, which overhauls the New Jersey Economic Development Authorities' tax incentives programs to encourage job growth, capital investment, and real estate development projects in New Jersey. Five pre-existing incentive programs were consolidated into two programs: the Grow New Jersey Assistance Program ("Grow NJ") and the Economic Redevelopment & Growth Grant Program ("ERG"). Grow NJ is now the main job creation and retention incentive offered by the state, under which base tax credits, which may be sold for not less than 75% of face value, range from $500 to $5,000 per job per year with potential bonus tax credits that can potentially increase the credit to a maximum of $15,000 per job per year in certain cases. Projects involving retained jobs may earn 50% of the amount of the benefit available for new jobs. The ERG Program is now New Jersey's main incentives tool for real estate development. Under this program, a developer that can demonstrate that a project requires a subsidy in order to close a project financing gap may apply for a grant of up to 75%-85% of the projected annual incremental state and local tax revenues resulting from the project.

New York – From 1986 through 2010, the primary economic development incentives program used by New York State was the Empire Zone Program. The Empire Zone Program provided a suite of tax credits, sales & use tax benefits, and utility rate reductions that was estimated to cost NYS approximately $500M per year in foregone tax revenue. In 2010, the Empire Zone Program was replaced with the Excelsior Jobs Program (EJP), which is now one of the state's primary economic development programs, and can be used for job growth or retention/investment projects. Qualified businesses may be eligible for up to four (4) refundable tax credits over a 10-year benefit period, with budgeted funding levels totaling $2.25 billion over the life of the program. From 2014-2021, the EJP is statutorily authorized to provide up to $200M per year in refundable tax credits for qualified projects.

North Carolina – North Carolina historically had a rich statutory tax credit environment and offered qualified businesses Article 3J tax credits which included a job creation credit, an investment tax credit, and a credit for investment in real property. These credits were repealed effective for business activities that occur after December 31, 2013. Claims for article 3J tax credits may still be filed either on an originally filed tax return or on an amended tax return filed within 6 months of the original return filing date, providing a short window in which to recognize benefits under this program. North Carolina now relies on a pre-existing discretionary incentive program, the Job Development Investment Grant (JDIG). The JDIG has an annual budget of $15M per year and provides grants based on new job creation and associated capital investment commitments. Grant funds are disbursed based on a percentage of withholding taxes paid by new employees.

— Jim Watts (Dallas)
Principal
Deloitte Tax LLP
jimwatts@deloitte.com

Douglas Tyler (New York)
Director
Deloitte Tax LLP
dtyler@deloitte.com

Jackie Hakimian (New York)
Manager
Deloitte Tax LLP
jhakimian@deloitte.com

Leveraging "Big Data" to manage the tax challenges arising from business travelers

There are many aspects of the US tax system that are not intuitive. Why is a business traveler from Texas subject to individual income tax on a business trip to New York but not when he/she travels to Illinois? And how does an employer know when to issue a Form W-2 to report the wages earned in different states for its employees travelling for business purposes? Learn how other organizations are taking steps to tackle these challenging and perplexing issues.

The corporate, payroll and individual income taxation of business travelers represent long-standing, but often ignored, tax obligations. The tax regulations in many jurisdictions require individual income tax to be paid in the jurisdiction in which the work is performed. So, organizations with employees who travel to other US states, or other countries, for business purposes should, in many cases, be addressing the associated payroll tax obligations. Often this requires the reporting of the remuneration associated with the business travel days and remittance of withholding taxes. Even when employers fail to meet their payroll tax obligations, the employees who travel for business purposes are required to self-report the income and pay the associated taxes through the filing of an individual (state) income tax return. With state and global tax authorities paying greater attention to the taxation of business travelers, and with the potential (and precedence) for the assessment of substantial penalties for noncompliance, organizations would be wise to evaluate their current practices – and the sooner the better.

Why the urgency? Looking to boost tax revenues, taxing authorities have become more vigilant about enforcing the law and are starting to apply more sophisticated technology tools and techniques to detect and monitor who is working within their jurisdictions, and for how long. Rather than pursuing the individual business travelers to collect tax revenues, the more common practice of taxing authorities is to address the collection issue directly with employers.

This activity is prompting a number of companies to address this issue for the first time. However, performing the necessary tracking of employees' work locations, calculating the allocation of remuneration, and operating of compensation reporting and tax withholding can be a daunting task. Where to start can be even more complex for large global enterprises that might have thousands of employees working outside their home jurisdictions at various times during the year.

This is a situation well suited for applying data analytics. Utilizing available data sources, such as travel records, expense reports, security badge scans, corporate jet logs and the like, it becomes possible to determine who is working where, when, and for how long. This information can then be used to calculate the income earned in a particular jurisdiction and the taxes owed, with the results fed into payroll systems to trigger compensation reporting, tax withholding and tax remittances.

Accessing and configuring data from multiple enterprise systems may be more time consuming to initiate than compiling data from other methods, such as asking employees to complete calendars to provide travel data. However, there are benefits of leveraging existing data sources. One advantage of this approach is that it reduces the time employees must spend providing data, allowing employees to focus their energies on their core job responsibilities. Another advantage of utilizing existing data sets is that it may be more reliable than what an employee may choose to provide, as the employees will quickly understand that the travel data they are providing may make their tax and financial situations more complex.

Companies with whom we have been working to implement an analytics-based approach also report other ancillary benefits stemming from their ability to track employee travel and location data, such as:

- Ability to negotiate better rates for travel insurance, airfares, and hotels;
- Being able to locate employees in the event of natural disasters or other emergencies;
- Stream-lined applications for applicable tax refunds, such as refunds for VAT levied on hotel stays;
- Enhancing the company's ability to make informed staffing decisions for projects, which in many cases can improve the project's ROI; and
- Assistance with identification of employees with excessive travel.

While HR typically takes the lead in driving compliance efforts in this area, other functions such as tax, legal, and internal audit may also have a stake in the effort. HR generally has responsibility for the establishment (or refinement) of travel policies, including the organization's approach to handling the employee's incremental tax costs. For example, when an employee from Texas (a state that does not levy individual income taxes) travels to New York (a state that requires business travelers to pay tax on all days worked in New York) will the employer reimburse the employee for the amount of any New York taxes owed? Or will the employee be responsible for paying the tax? Also, will the employer assist the individual (perhaps through the provision of a stipend) with the additional tax return filing obligation that arises from the employee's trip to New York? Having the buy-in and support of those involved within the organization to consider the implications, set and communicate policies, and establish data collection and tax remittance procedures should help smooth the path to compliance.

A bill (H.R. 1129: Mobile Workforce State Income Tax Simplification Act of 2013) is currently in committee in Congress (since March 2013) that seeks to impose a 30-day threshold before states can collect taxes on non-residents working in their state. Previous bills on the topic failed to pass, so organizations should not be relying on future legislation to clarify and help ease some of their tax and administrative burdens.

Instead, given recent stepped-up enforcement and the risk of substantial noncompliance penalties, organizations should focus on addressing business traveler taxation requirements efficiently and effectively. Using workforce analytics to leverage existing data sources is helping many organizations do just that – a great example of how Big Data can help meet a big challenge.

— John Jennings (Chicago)
Partner
Deloitte Tax LLP
johjennings@deloitte.com

Lorraine Cohen (San Francisco)
Partner
Deloitte Tax LLP
lcohen@deloitte.com

US Estate and gift taxation of resident aliens and nonresident aliens

Non-US citizens, both resident and nonresident aliens, may be subject to US estate and gift taxes. Whether in the United States indefinitely, for a long-term stay, or short-term assignment, the death of a non-US citizen may have adverse US estate tax consequences. Likewise, lifetime transfers by non-US citizens may be subject to US gift tax. This publication will provide an overview of the questions that must be addressed by non-US citizens who live, work, or own property in the United States.

Despite certain efforts to repeal it, in early 2013, Congress passed and President Obama signed into law the permanent reinstatement of the estate tax, with a maximum tax rate of 40% and an exemption amount of $5 million (indexed for inflation) for US citizens and US domiciliaries. The indexed exemption amount for 2014 is $5,340,000.

However, as has always been the case, the exemption amount for non-US domiciliaries remains at only $60,000, unless increased by treaty.

What should I consider when moving to the United States?

Should I get a green card? – Obtaining a green card is one way to establish residency in the United States. Having a green card allows for easier travel into and out of the United States and will allow you to remain in the United States indefinitely. However, a green card will subject you to US income tax on your worldwide income during the entire time that you hold the green card (even if you are living outside the United States), and it may subject you to US estate and gift tax on your worldwide assets if you make gifts or die while holding the green card (see discussion below).

What happens if I later give up my green card? – Surrendering your green card will cause you to be considered a nonresident alien for US income tax purposes (assuming you do not spend substantial time in the United States after surrendering your green card and, therefore, become a US resident under the substantial presence test). However, upon surrendering your green card, you will need to consider whether you are subject to the US "exit tax." US law imposes a "mark-to-market" exit tax applicable to US citizens who expatriate and certain long-term green card holders who relinquish their green cards after June 16, 2008 (a "covered expatriate"). The law also imposes a tax on US citizens or residents who receive certain gifts or bequests from covered expatriates (including distributions from certain foreign trusts). A covered expatriate is a person who renounces US citizenship or who relinquishes a green card after holding it during any portion of at least eight of the last fifteen years and who:

1. Had an inflation adjusted average annual net income tax liability for the five preceding years of more than $157,000 (for 2014; the 2013 amount was $155,000);
2. Had a net worth of $2,000,000 or more; or
3. Failed to certify compliance with US tax obligations for the prior five years.

Under the exit tax, covered expatriates are treated as having sold all of their worldwide property in a fully taxable transaction on the day before their expatriation date. Covered expatriates must recognize gain on all unrealized gains resulting from such deemed sale to the extent they exceed $680,000 (for 2014, adjusted annually; 2013 amount was $668,000).

Estate tax

Will I be considered a US domiciliary for estate tax purposes? – A person is considered to be domiciled in the United States for estate and gift tax purposes if they live in the United States with no present intention of leaving the United States.

A facts and circumstances test is used to determine domicile and takes into consideration the following factors:

- Statements of intent (in visa applications, tax returns, wills, etc.);
- Length of US residence;
- Whether the person has a green card;
- Style of living in United States and abroad;
- Ties to former country;
- Country of citizenship;
- Location of business interests; and
- Place where club and church affiliations, voting registration, and driver licenses are maintained.

A person is considered a non-US domiciliary (i.e. a nonresident alien) for estate and gift tax purposes if he or she is not considered a domiciliary under the facts and circumstances test described above.

Please be aware that residency for estate and gift tax purposes is determined differently than residency for income tax purposes. Thus, you may be a resident alien for income tax purposes, but a nonresident alien (hereinafter, non-US domiciliary) for estate and gift tax purposes.

Also, please note that due to the subjective nature of this test, it is often difficult to determine an individual's domicile for US estate and gift tax purposes with any degree of certainty. It is, therefore, important to consult with a professional experienced in international estate planning in order to determine your potential US estate tax exposure and implement appropriate planning steps.

Which of my assets will be taxed in the United States upon my death? – US domiciliaries are taxed on the value of their worldwide assets owned at death in the same manner as US citizens.

Non-US domiciliaries are taxed only on the value of their US "situs" assets. Generally, US situs assets include real and tangible personal property located in the United States, business assets located in the US, and stock of US corporations. Please note that the definition of US situs assets may be modified by an applicable Estate and Gift Tax Treaty.

Are there any credits or deductions available? – Applicable exemption amounts are available against gift tax and estate tax for US citizens and domiciliaries. US citizens and domiciliaries may transfer $5,340,000 in 2014 (indexed for inflation; in 2013 this amount was $5,250,000) free of either US gift tax or US estate tax. Any lifetime usage of the exemption by a US domiciliary will offset the exemption available at his or her death.

Upon the date of death, the decedent's estate will receive a "step-up" in basis such that the estate's (and beneficiaries') income tax basis in the decedent's assets will be the fair market value on the date of death (or the alternate valuation date if elected by the executor).

Non-US citizens who are non-US domiciliaries are generally allowed a reduced estate tax exemption amount, which permits only $60,000 of US situs assets to be transferred free of US estate tax. Note that this amount may be increased by an applicable Estate and Gift Tax Treaty.

How is jointly owned property taxed? – Generally, the portion of jointly owned property that is taxed in the estate of the first spouse to die is based upon who provided the "consideration" to purchase the property (i.e., whose assets were used to purchase the property) if the surviving spouse is not a US citizen.

The portion of the property included in a decedent's estate is calculated based on the portion of consideration, which the decedent furnished for the property. Special rules apply to community property or property purchased with community funds.

However, if the surviving spouse is a US citizen (regardless of the domicile status of the deceased spouse), generally, half of the value of jointly owned property will be included in the estate of the first spouse to die.

What are the tax rates? – Estate and gift tax rates currently range from 18% to 40%. The rates are the same whether you are a US citizen, US domiciliary, or non-US domiciliary.

Note that the particular US state in which a non-US citizen resides may impose additional estate and gift taxes.

Is double taxation a possibility? – Yes. Since every country applies different standards to determine domicile, it is possible that two or more countries will consider the same person a domiciliary. Also, property may be taxable in the jurisdiction in which it is located or based on the residency of the recipient. In such cases, certain assets may be subject to estate tax in both countries. Proper planning along with Treaties and Foreign Tax Credits may eliminate or reduce double taxation.

Will property transferred to my spouse be subject to US estate tax? – The answer depends on whether your spouse is a US citizen.

If your surviving spouse is a US citizen, there is an unlimited marital deduction. In other words, an unlimited amount of assets can pass to your spouse without being subject to US estate tax. Furthermore, if you and your spouse are US citizens or domiciliaries and the executor of the estate of the first spouse to die makes an election on a timely filed estate tax return, any of the $5,340,000 (in 2014) exemption that the first estate does not utilize will be available for the surviving spouse to use, in addition to his or her own $5,340,000 exemption (referred to as "portability" of the exemption).

If either you or your surviving spouse is not domiciled in the United States for estate tax purposes, portability is not available. If that is the case, the surviving spouse is only entitled to his or her own exemption based on his or her status as a US citizen, US domiciliary, or US nondomiciliary at the time of his or her death and the exemption available under the US estate tax rules in place at that time.

In addition, if your surviving spouse is not a US citizen, the marital deduction is generally not allowed. However, a deferral of tax for assets passing to a non-US citizen surviving spouse may be obtained if US property passes through a Qualified Domestic Trust (QDOT). In addition, some Estate and Gift Tax Treaties allow for some form of a marital deduction in cases where such a deduction would not normally be available.

With which countries does the United States have Estate and Gift Tax Treaties? – The US currently has Estate and Gift Tax Treaties with the following 18 countries: Australia, Austria, Belgium, Canada (through the income tax treaty), Denmark, Germany, Finland, France, Greece, Ireland, Italy, Japan, Netherlands, Norway, South Africa, Sweden, Switzerland, and the United Kingdom.

Gift tax

What transfers are subject to gift tax? – US gift tax is imposed on "taxable gifts" (total gifts less exclusions and deductions) made by US citizens, US domiciliaries, and non-US domiciliaries as follows:

- US citizens and domiciliaries are subject to gift tax on all transfers of property, regardless of where the property is located.
- Non-US domiciliaries are subject to US gift tax only on transfers of tangible personal property situated in the United States and real property situated in the United States. Gifts of intangible property, regardless of where located (such as stocks and bonds), made by a non-US domiciliary are not subject to US gift tax.

Are any transfers excluded from gift tax? – There is an annual exclusion available which exempts up to $14,000 (in 2014; indexed for inflation in $1,000 increments) per donee per year of "present interest" gifts from US gift tax. US citizens and domiciliaries can "gift split," which, in effect, allows a married donor to exclude up to $28,000 per donee per year. However, if either spouse is a non-US domiciliary, gift splitting is not permitted.

The $14,000 annual exclusion amount is increased for gifts to a non-US citizen spouse to $145,000 per year in 2014 (indexed annually). In contrast, an unlimited amount can be gifted to a spouse who is a US citizen pursuant to the unlimited marital deduction. It is important to note that a QDOT may not be used in order to obtain a marital deduction for transfers made to a non-US citizen spouse during life. Also, an applicable Estate and Gift Tax Treaty may allow for some form of a marital deduction in cases where such a deduction would not normally be available.

Are any credits available? – As mentioned above, the gift tax exemption for US citizens and domiciliaries is $5,340,000. However, any part of the $5,340,000 used during life will offset the applicable exemption amount available at death.

For non-US domiciliaries, a $60,000 applicable exemption amount is available for transfers made at death only. Other than the annual exclusion, there is no exemption amount available for lifetime transfers by non-US domiciliaries.

Generation-Skipping Transfer Taxes

What transfers are subject to the Generation-Skipping Transfer Tax? – The Generation-Skipping Transfer Tax ("GST tax") is imposed on US taxable gifts and bequests (i.e., transfers of worldwide assets by US citizens and domiciliaries, gifts of US situs tangible property by non-US domiciliaries, and bequests of US situs tangible and intangible property by non-US domiciliaries) made to or for the benefit of persons who are two or more generations below that of the donor (e.g., a grandchild). GST tax is also imposed on gifts made to donees who are not related to the donor and who are more than 37.5 years younger than the donor. GST tax is imposed in addition to estate and gift taxes.

Are any transfers excluded from GST tax? – In limited circumstances, a GST annual exclusion (in the same amount as the gift tax annual exclusion) is available. Most gifts made through trusts do not qualify for the GST annual exclusion.

In addition, there is a GST exemption which exempts $5,340,000 (the same amount as the estate and gift tax exemption; indexed annually for inflation) of assets from GST tax. The exemption is available for all transfers made both during life and after death by US citizens, US domiciliaries, and non-US domiciliaries that are subject to GST tax. The highest GST tax rate is 40%.

— Karen Brodsky (New York)
Partner
Deloitte Tax LLP
kbrodsky@deloitte.com

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

September 24	Dbriefs webcast: New Global Transfer Pricing Documentation Standards and Valuation of Intangibles : Prepare for Change http://usdbriefs.com/0924tparchivepagereg
October 9	Dbriefs webcast: Tax Information Reporting: New Forms & Year End Reporting http://usdbriefs.com/tc1009eventreg
October 23	Dbriefs webcast: Building the Business Case for Tax Transformation http://usdbriefs.com/ops1023seriespagereg
October 30	Dbriefs webcast: US Inbound Investment: Tax Considerations of Financing Alternatives http://usdbriefs.com/it1030seriespagereg
November 12	Dbriefs webcast: State Transfer Pricing: Are you Prepared for Increased Scrutiny? http://usdbriefs.com/tp1112homepagereg

Recent and Upcoming Tax Developments

September 19	OECD Releases the BEPS Project 2014 Deliverables update http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-190914.pdf
September 19	OECD Release on Intangibles: Many Issues Unanswered http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-tpalert-2014-16.pdf
September 17	OECD Release on Transfer Pricing Documentation: The New Global Standard http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-tpalert-2014-014.pdf
September 16	OECD Releases First Set of BEPS Deliverable http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-unitedstates-160914.pdf
September 11	Updated: Schumer Anti-Inversion Bill http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-unitedstates-110914.pdf

August 1	The Stop Corporate Earnings Stripping Act of 2014 http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-unitedstates-040814.pdf

Have a question?
If you have needs specifically related to this newsletter's content, send us an email at **clientsandmarketsdeloittetax@deloitte.com** to have a Deloitte Tax professional contact you.

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.