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Tax

# U.S. Inbound Corner

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## Transfer Pricing Year-End Action Item: Competent Authority Notifications to Address Risk of Double Taxation

As year-end approaches for calendar year taxpayers, we would like to remind taxpayers of the actions required to preserve the right to request competent authority assistance to relieve double taxation.

Competent authority assistance for double taxation is provided under the mutual agreement procedure (MAP) article of the relevant tax treaty. To obtain relief from double taxation, the US and other countries' competent authorities must be notified of the proposed adjustments, or a request for MAP assistance must be filed, within specified deadlines. In the case of an IRS-initiated adjustment, the foreign tax authority must be notified, and in the case of a foreign-initiated adjustment, the IRS must be notified. Failure to make the appropriate filings can result in the IRS or foreign tax authority denying the taxpayer's request for competent authority relief to eliminate double taxation. In addition, taxpayers should not sign closing agreements with the tax authorities if they intend to request competent authority assistance, because doing so may limit their ability to obtain relief from double taxation.

In 2013, 82 percent of new cases related to foreign-initiated adjustments. Given the ever-increasing aggressiveness of foreign tax authorities, taxpayers must be increasingly vigilant


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regarding the treaty deadlines to protect the right to request competent authority assistance. These treaty deadlines can and do differ from domestic statutes of limitations, and taxpayers must take protective actions to keep recourse to competent authority open. The fact that the domestic statute of limitations may still be open for transfer pricing assessments in one or both of the affected countries is not determinative of the availability of competent authority assistance.

We strongly recommend that taxpayers that are either subject to a foreign tax audit, or that have a reasonable expectation that they may be subject to a foreign tax audit, review the relevant treaty timelines and take all necessary protective measures. Taxpayers do not need to wait until the conclusion of a transfer pricing audit to take such measures.

Failure to notify the IRS (or foreign tax authority) within the specified time frames will likely preclude the taxpayer from seeking competent authority relief from double taxation, and may also give rise to issues regarding the creditability of foreign taxes. See Procter & Gamble Co. v. US, (S.D. Ohio, Case No. 1:08-cv-00608, defendant's motion for summary judgment granted 7/6/10).

The table below summarizes the notification/action requirements and applicable time limitations for requesting competent authority assistance between the United States and all of its current treaty partners. Many treaties require notification to the tax authority that did not propose the adjustment within a certain number of years of the taxpayer's tax year end or the filing of a tax return. Please note that the statute of limitations for a tax adjustment may extend past the due date for notification under the US-Mexico tax treaty. Consequently, we strongly advise taxpayers to file notifications with the IRS APMA program at the onset of any Mexican tax examination.

Taxpayers should consult with their tax advisors to evaluate the relevant provisions of the applicable treaty and their specific application to the taxpayer's facts and circumstances. The contact persons listed below can assist you in preparing the required notifications.

| US Treaty Partner | Notification/Action Deadline per Treaty |
|---|---|
| Australia | The case must be presented within three years from the first notification of the tax authority action giving rise to taxation not in accordance with the provisions of the treaty. |
| Austria | No deadline. |
| Bangladesh | No deadline. |
| Barbados | No deadline. |
| Belgium | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Bulgaria | No deadline. |
| Canada | The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within six years from the end of the taxable year to which the case relates. |


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| US Treaty Partner | Notification/Action Deadline per Treaty |
| --- | --- |
| China | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Cyprus | No deadline. |
| Czech Republic | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Denmark | No deadline. |
| Egypt | No deadline. |
| Estonia | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Finland | The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within six years from the end of the taxable year to which the case relates. |
| France | The case must be presented within three years of the notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Germany | The case must be presented within four years from the notification of the assessment giving rise to double taxation or to taxation not in accordance with the provisions of the treaty. |
| Greece | No deadline. |
| Hungary | No deadline. |
| Iceland | No deadline. |
| India | The case must be presented within three years of the date of receipt of notice of the action that gives rise to taxation not in accordance with the treaty. |
| Indonesia | The case must be presented within three years of the first notification of the action giving rise to taxation not in accordance with the provisions of the treaty. When a combination of decisions or actions taken in both countries results in taxation not in accordance with the provisions of the treaty, the three-year period begins to run only from the first notification of the most recent action or decision. |
| Ireland | No deadline. |
| Israel | No deadline. |
| Italy | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Jamaica | No deadline, except that the taxpayer or the competent authority of the United States must give notice within the time limits established by the domestic law of Jamaica to the competent authority of Jamaica that there may be a claim for tax adjustment. |
| Japan | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Kazakhstan | No deadline. |


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| US Treaty Partner | Notification/Action Deadline per Treaty |
|---|---|
| Korea | No deadline. |
| Latvia | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Lithuania | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Luxembourg | No deadline. |
| Malta | No deadline. |
| Mexico | The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within four and a half years from the due date or the date of filing of the return in that country, whichever is later. |
| Morocco | No deadline. |
| Netherlands | The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within six years from the end of the taxable year to which the case relates. |
| New Zealand | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Norway | No deadline. |
| Pakistan | No deadline. |
| Philippines | No deadline. |
| Poland | No deadline. |
| Portugal | The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Romania | No deadline. |
| Russia | No deadline. |
| Slovakia | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Slovenia | The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| South Africa | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty (or in the case of tax collected at source, within three years from the date of collection). |
| Spain | The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Sri Lanka | No deadline. |
| Sweden | No deadline. |
| Switzerland | No deadline. |


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| US Treaty Partner | Notification/Action Deadline per Treaty |
|---|---|
| Thailand | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. |
| Trinidad and Tobago | No deadline. |
| Tunisia | No deadline. |
| Turkey | The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within five years from the end of the taxable year to which the case relates. |
| Ukraine | No deadline. |
| United Kingdom | The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty or, if later, within six years from the end of the taxable year or chargeable period in respect of which that taxation is imposed or proposed. |
| Venezuela | No deadline; however, the statute of limitations must be "interrupted in accordance with the steps designated by domestic laws." |

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## The FATCA Challenge

The Hiring Incentives to Restore Employment (HIRE) Act which became law in 2010 contained the essential provisions for the Foreign Account Tax Compliance Act (FATCA). FATCA, through new Chapter 4 of the Internal Revenue Code, seeks to identify US person's income and accounts from non-US financial institutions. It requires these foreign financial institutions (FFIs) to register and report information about the financial accounts held by US taxpayers directly to the IRS. In addition, it requires certain non-financial Foreign Entities to report substantial US owners or to certify no US ownership. The price of FATCA noncompliance for FFIs, NFFEs or investors is a 30% withholding tax on certain US source income and gross proceeds.

The impact of FATCA rules on financial institutions and investment funds both in the US and offshore should be obvious, but many global companies may wrongly assume that if they are not in the financial services industry FATCA will have little impact on them. However, FATCA will impact almost every multinational enterprise, including those in non-financial businesses. The 30% withholding tax must be applied by the payers (called withholding agents) to withholdable payments unless they receive appropriate documentation of the payees Chapter 4 status.


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## Timeline

Generally, withholding agents were required to be in compliance as of July 1, 2014. Although, transition relief issued earlier this year effectively delayed the impact on companies in the non-financial sector to January 1, 2015.

## What kinds of transactions make up a withholdable payment?

Payments like interest and dividend income and gross proceeds from the sale or disposition of property produce US source interest and dividends and are typically thought of as withholdable payments. In addition, withholdable payments also include insurance premiums, retirements of indebtedness, loan guarantees and even payments on loan principal.

Some additional examples of non-financial company payments that can be subject to FATCA are:

- US borrower obtaining a loan from a foreign or US financial institution that does not provide proper documentation;
- Hedging transactions;
- Issuance of private placement debt by a US entity;
- Purchase of US subsidiary from a foreign entity;
- Payments of insurance premiums to captive or unrelated insurance companies or brokers; and
- Payments of interest or dividends to trustee banks or transfer agents.

## Off-shore employee benefit and retirement plans in a post FATCA world

FATCA defines “financial institution” very broadly. Any foreign entity conducting financial transactions may be considered an FFI. For example, funded non-US retirement and benefit plans are generally classified as FFIs. As previously noted, employers must register all FFIs unless the FFIs are exempt under FATCA. Registered plans would need to put into place due diligence procedures to identify and document participants and would be required to report any US persons on an annual basis. There are several exemptions specifically relevant to retirement plans under the FATCA Regulations, as well as the Intergovernmental Agreements with various countries. In addition, non-funded retirement and benefits plans may be excluded from FATCA coverage.

Many employers are in (or have recently completed) the process of classifying their non-US retirement and benefit plans under FATCA. In connection with this analysis, employers should also consider how other income tax withholding and reporting requirements could apply to these plans. For example, income inclusion could result from contributions to, and accrued earnings in, a foreign retirement or benefit plan while an employee is a resident of the US or a US citizen, even though treaty relief may be available.

With the continued focus on this area, it is recommended that employers and employees understand the issues regarding US tax treatment of contributions and earnings associated with foreign retirement or benefit plan participation. We recommend that the employer analyze


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this area annually for their in-bound assignee population. The employer should have a general understanding of how the company handles amounts that are included on Form W-2. In addition, if such amounts are not to be included on Form W-2 then it should be because the company has analyzed this area and has concluded the amounts are not currently taxable or the amounts are to be reported by the foreign retirement or benefit plan.

### A word about the new reporting forms under FATCA

Recently in response to the new FATCA rules the IRS has released many revised tax forms such as W-9, W-8BENE, W-8BEN. These revised forms have been expanded to include new terminology, various validity periods and new FATCA classifications that has caused a lot of confusion for the withholding agents collecting them. There is real risk for withholding agents in failing to have a good process for validating these forms, maintaining source documentation and establishing withholding status and exemptions. It is clear that developing and maintaining formal policies and processes are essential to achieving good corporate governance. Going forward documenting the policies and maintaining records will be an important step in limiting risk for future audits.

### What's really at stake?

What is certain is that withholding agents have real risk in failing to comply with the FATCA rules since certain US source income paid to payees will be subject to 30% withholding unless they obtain valid documentation of exemption or reduced rate. Withholding agents that fail to properly withhold, are liable for the withholding itself and can face significant interest and penalties. So withholding agents need to know the rules, have a policy and process in place and maintain proper documentation or withhold.

The IRS has formed new withholding teams in major locations like New York, California, Illinois, New Jersey and Texas and hired a significant number of agents to focus on FATCA withholding and reporting. New IRS Information Documentation Requests make it clear that the IRS will be reviewing a company's formal policies and processes for identifying foreign payments, withholding records, Forms W-9, Forms W8 BENE and tax returns like Forms 1042. They will also be looking at procedures for determining source, withholding status and FATCA classifications. Doing nothing is simply not an option as companies need to get ahead of the challenge that these new FATCA rules pose.

### Next steps for consideration

The suggested next steps for an in-bound company to consider in order to achieve FATCA compliance, include:

- Perform an analysis to classify all legal entities, including non-US retirement and benefit compensation plans;
- Determine whether the inventoried legal entities are exempt under an IGA, treaty or other regulatory provision;
- If not exempt, register the legal entity as an FFI and adopt due diligence procedures to identify and document specified US account holder;


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- If exempt, develop and retain documentation to validate exempt status;
- Review new IRS tax documentation, including the new Form W-8BEN-E (i.e., the Certificate of Foreign Status of Beneficial Owner for United Status Tax Withholding). This form along with Forms W-8ECI, W8EXP, and W-8IMY, have been updated to reflect the documentation requirements of FATCA; and
- Evaluate tax positions annually of US tax treatment of contributions and earnings associated with foreign pension plan participation by those individuals subject to US taxation (i.e., US citizens and residents).

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## Review of Accounting Methods and Elections in Connection With Year-End Tax Planning

As companies approach year-end, they should be mindful of several tax planning opportunities that maybe available and may also be fairly straightforward to implement. Companies should consider their current accounting methods as potential tax saving opportunities that may be obtained through the filing of accounting method changes. Furthermore, companies should consider these opportunities since they may have a desire to increase or decrease taxable income depending upon their particular circumstances. For example, if a company has expiring credits (GBC, foreign, etc.) or NOLs, they may need to increase taxable income. On the other hand, companies generally desire to reduce taxable income to maximize their cash flow. Some of the ideas require certain analyses to be performed and some of the ideas involve filing a change in accounting method which may be due by December 31, 2014 for calendar year taxpayers. Accordingly, companies should evaluate their circumstances sooner rather than later.

### Accounting method changes

An accounting method change may involve conversions from an impermissible method to a permissible method or from a permissible method to another permissible method. Certain accounting method changes are automatic while others require advance consent from the Internal Revenue Service.[1] The following are some items that can be changed automatically:

- Repair costs;
- Bonuses;
- Inventory:
    - Lower of cost or market/subnormal goods/UNICAP/LIFO enhancements;
- Foreign E&P;
- Depreciation changes:
    - Ready and available/class to class:

[1] Refer to Revenue Procedure 2011-14 for further guidance.



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- IBNR (incurred but not reported):
  - Self-insured medical;
  - Medical services included in workers' compensation;
- Changes to comply with Treas. Reg. §1.263(a)-4, including prepaid expenses;
- Payroll taxes;
- Advance payments;
- Software development costs;
- Single item cash to accrual:
  - Does not include payment liabilities;
  - Does include rebates and other allowances;
- Nonaccrual experience method;
- Changes to comply with gift card guidance; and
- Changes to comply with Section 467.

Items eligible for automatic consent can be made by filing Form 3115, Application for Change in Accounting Method, by the extended due date of the tax return for the year of the change.[2]

Changes in accounting methods requiring advance consent are more complex and are reviewed by the National Office of the Internal Revenue Service. Changes requiring advance consent are filed pursuant to Revenue Procedure 97-27. Submission of a request for changes requiring advance consent is made by filing Form 3115 during the year and no later than the end of the year of change. For calendar year taxpayers, this would mean that the Form 3115 for changes related to the 2014 year would need to be submitted by December 31, 2014. There is a $7,000 user fee for requesting the change.[3]

Accounting method changes generally results in an IRC 481(a) adjustment. Unfavorable adjustments are amortized and reflected in the taxpayer's Federal income tax return over four years. Favorable adjustments are reflected in the taxpayer's Federal income tax return in the year in which the application is made and/or approved.

**Other potential planning opportunities**

The following are some other opportunities to increase or decrease taxable income in order to meet the company's specific objective.

It should be noted that not all income and expense items require a method change. Some of these items include:

- Specified liability losses;
- Disputed sales and other exclusions from income;
- Casualty and abandonment losses;
- Accelerating payment liabilities on the sale of a business;

[2] There is no fee for requesting the automatic change.
[3] Refer to Revenue Procedure 2014-1 for additional guidance.


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- Depreciation:
    - Changes to be placed in service dates;
    - Bonus depreciation;
- Credits in lieu of bonus depreciation;
- Write-off of worthless intangibles;
- Bad debts:
    - Including partially worthless bad debt;
- Section 199:
    - Treatment of prior period expenses;
- Inventory:
    - UNICAP: Adopt Historic Absorption Ratio method;
    - Expand or adopt LIFO;
- Election under Section 59(e) to capitalize R&D costs;
- Election under Section 266 to capitalize taxes and carrying charges; and
- Elections under Treas. Reg. §1.263(a)-4.

**Acceleration of business deductions**

**Bonus depreciation – placed in service by 12/31/2014 for longer production:** Generally, bonus depreciation provisions (IRC Section 168(k)) have not been extended beyond tax year 2013. However, be mindful that the 50% bonus depreciation provisions may be still available for long production property that is placed in service by January 1, 2015 and otherwise qualifies for bonus depreciation. Long production property is defined as being subject to §263A, has a production period greater than one year, costs more than $1 million and has a MACRS life of at least three years or is involved in the business of transporting property or people. In the case of non-commercial aircraft, any payment made prior to January 1, 2015 would qualify. For all other property, only payments made prior to January 1, 2014 would qualify.

**Tangible personal property:** Taxpayers interested in accelerating business expenses should review the provisions of the final tangible personal property regulations (Treasury Decision 9636). Although taxpayers could have adopted these rules in 2013, it is mandatory that taxpayers apply these rules in 2014. Taxpayers can evaluate whether amounts paid with respect to tangible personal property can be expensed or capitalized.

Costs to improve tangible property can result in:

- Capitalizing the improvements to tangible property;*
- Deducting the repair and maintenance costs;*
- Electing to deduct *de minimis* amounts;
- A method change to the safe harbor for routine maintenance;*
- A method change to the regulatory accounting method; and*
- Electing to follow book capitalization.

  * These items can be subject to retroactive changes and should be a main area of consideration.


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Taxpayers making the *de minimis* safe harbor election can deduct the repair expense in their timely filed 2014 Federal income tax returns. To qualify, the taxpayers must have applicable financial statements ("AFS"), a written capitalization policy as of the beginning of the taxable year for expensing property for financial statement purposes. Under the *de minimis* safe harbor provisions, the amount paid for the property should not exceed $5,000 for each item or per invoice. Making the election allows taxpayers with capitalization policies in excess of $5,000 to protect tangible units of property acquired up to $5,000. The excess amount will be subject to the accounting method the company already has in place. If a company does not have an AFS, the deduction is limited to $500.

Materials and supplies are generally defined as tangible property used in the taxpayers' operations that is not inventory and is a component acquired to maintain, repair, or improve a unit of property. This includes fuel, lubricants, water, or similar items that are reasonably expected to be consumed in less than 12 months, has an economic useful life of 12-months or less, or has an acquisition or production cost less than $200. Upon investigation of these costs, taxpayers can determine the timing of their deductions by:

- Deducting incidental materials and supplies when paid or incurred;
- Deducting non-incidental materials and supplies when used or consumed;
- Deducting non-incidental rotable and temporary spare parts when disposed of;
- Changing to the optional method for rotable and temporary spare parts;
- Make an annual election to capitalize rotable and temporary spare parts; and
- Consider making a *de minimis* safe harbor election.

**Deceleration of business deductions**

If there is a desire to increase taxable income, the following ideas should be considered regarding deferring certain current expenditures:

**Elect to treat employee compensation, overhead or de minimis costs paid in the process of investigating or otherwise pursuing a transaction as amounts that facilitate the transaction (Treas. Reg. § 1.263(a)-4(e)):** In general, employees and related overhead costs paid in connection of facilitating or pursuing a transaction are considered business expenses or deductions. Taxpayers may elect to capitalize these facilitative costs paid in the process of investigating or pursuing a transaction. An election is made separately for each transaction and applies to employee compensation, overhead, or *de minimis* costs, or any combination thereof. Employee compensation generally consists of salary, bonuses and commissions paid to an employee of the company and *de minimis* costs are amounts (other than employee compensation and overhead) paid in the aggregate are not in excess of $5,000.

**Elect not to apply the 12-month rule to similar items incurred during the tax year (e.g., prepaid expenses including insurance, warranty, and service contracts)(Treas. Reg. § 1.263(a)-4(f)(7)):** Taxpayers are generally not required to capitalize costs paid for items such as prepaid expenses (i.e. insurance, licenses and leases), warranty expense, or service contracts, where the period of coverage is less than 12 months. However, taxpayers that are


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interested in reducing their business deductions may elect to capitalize and defer these expenses.

**Elect to treat amounts paid for employee compensation or overhead as amounts that facilitate the acquisition or tangible property (Treas. Reg. § 1.263(a)-2(f)(2)(iv)(B)):** In general, employee compensation and overhead costs paid in connection of facilitating or pursuing the acquisition of real or personal property are considered business expenses or deductions. Taxpayers may elect to capitalize and defer these costs paid for employee compensation or overhead expenses as amounts that facilitate the acquisition of property. An election is made separately for each acquisition and applies to employee compensation or overhead, or both. *De minimis* costs are amounts (other than employee compensation and overhead) paid in the aggregate are not in excess of $5,000.

Taxpayers must make the elections to capitalize the above items on their timely filed original Federal income tax return (inclusive of extensions) for the taxable year in which the costs are paid. Elections can be made on an annual basis and may revoke an election only by filing a request for a private letter ruling and obtaining the consent of the Commissioner.

**Tax credits:** Taxpayers with excess and potential expiring credits, such as foreign tax credits (“FTC”), may be in search of possible opportunities for positive income or earnings and profits. Taxpayers can review their current accounting procedures at the controlled foreign corporation (“CFC”) level. Similar to accounting method changes available at the corporation level where taxpayers can change the lifetime deduction of business expenses, CFCs generally can also make these types of changes. Changes made to defer deduction or accelerate income will allow taxpayers with expiring credit to increase their earnings and profits in order to increase their credits.

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## Long-Term US Travel Hotel Tax – Potential Refund Opportunity

*Does your company send employees to the US for long-term assignments? If so, consider this potential opportunity for recovery of overpaid hotel occupancy taxes.*

Nearly all states and their political subdivisions impose a “transient” or “hotel occupancy” tax (referred to here as “hotel occupancy tax”) on the price paid for the provision of lodging accommodations. State and local hotel occupancy tax rates routinely exceed 15% and may approach 20% percent in some jurisdictions. While the liability for hotel occupancy tax and the obligation to collect and remit such tax generally rest with the hotel operator, the economic burden of the tax is typically passed on to the persons occupying the hotel rooms.

As a general rule, only transactions involving temporary occupancy are subject to the tax. The definition of “temporary” is specific to each state or local taxing jurisdiction, with many


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jurisdictions applying a threshold ranging from 30 to 90 days of consecutive occupancy to delineate temporary (i.e., taxable) from permanent (i.e., exempt) lodging. This effectively creates a “permanent resident exemption” for long-term stay. Where both a state and a local jurisdiction located within that state have authority to tax the same transaction, each may provide its own unique permanent resident exemption criteria.

For instance, both New York State and New York City impose tax on the rental of hotel rooms. Both jurisdictions provide exemptions for permanent residents. New York defines permanence in this context as at least 90 consecutive days of occupancy, while New York City defines it as 180 days of consecutive occupancy.[4]

Adding to the complexity of differing definitional terms is the related issue of who is eligible to claim the permanent residency exemption. Certain jurisdictions have explicit statutes or administrative rules providing that the exemption extends to non-natural persons, i.e., corporations, partnerships and LLCs. For example, both Minnesota and New York have issued regulatory guidance that the permanent resident exemption applies to corporations and other business forms.[5] Other jurisdictions, however, such as the City of Los Angeles and the Louisiana Department of Revenue, specifically limit the permanent resident exemption to natural persons.[6] And, in many taxing jurisdictions the issue may not be directly addressed. Accordingly, the opportunity for a business to claim the exemption must be explored on a jurisdiction-by-jurisdiction basis.

Determining eligibility for the permanent residency exemption is further complicated by the data requirements necessary to accurately track consecutive night stays in a given hotel. Refund claims must be supported by sufficient documentation, which may include hotel contracts, hotel invoices and portfolios, and payment detail. Ideally, this data is available in electronic format to facilitate analysis, but this may not always be the case.

The technical complexities of capturing and processing the necessary data coupled with the practice of some hotel operators of applying a conservative approach when considering the permanent resident exemption, may lead to significant tax overpayments in this area. In addition, the common practice of using third-party hotel reservation agents to manage corporate travel may further complicate the tax issue.

Deloitte Tax LLP can assist companies in navigating state and local hotel occupancy taxes, including the complex “permanent resident exemption” rules, in the following manner:

1. Reviewing hotel transactions and helping to organize the applicable data;
2. Assisting with the timely filing of refund claims; and
3. Reviewing potential approaches for prospectively reducing hotel occupancy tax liability.

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[4] Sec. 1105(e)(1); N.Y. Comp. Codes R. & Regs. § 527.9(b)(8); N.Y.C. Admin Code §§ 11-2502(b) and 2501(8).
[5] Minn. R. 8130.1000; N.Y. Comp. Codes R. & Regs. § 527.9(b).
[6] Los Angeles Municipal Code Ordinance § 21.7.2(d); Louisiana Dept of Revenue, Revenue Ruling No. 07-003, (Sept. 6, 2007).


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We encourage current inbound investors to consider this service offering as part of their long-term travel program.

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## Ten Tax Considerations for Individuals Inbound to the US

Individuals moving to the United States are often surprised with the complexities of the US tax system. This article highlights ten tax considerations with which individuals should be familiar prior to moving to the US.

1. **Potential opportunities exist for income tax planning in the years of arrival and departure:** The US tax system treats certain types of income and deductions differently depending on the residency status of an individual taxpayer. Tax planning opportunities may be available to adjust the residency start date of an individual, which may help limit US taxation in the year of arrival and/or departure. Factors including the time of year when a person first moves to the US, the number of days spent in the US during the year, home country residency status, and other personal considerations can have an impact on the residency status, and therefore the tax implications for an individual. Examples of certain planning opportunities include modifying travel plans to impact residency start/end dates and raising the basis of certain assets prior to arrival to the US. Prior to arrival/departure, individuals should consult a tax advisor to determine if a favorable tax filing position or other tax planning is available.
2. **An individual can extend the time to file their US income tax return, but not the time to pay the tax due:** The US federal individual income tax return is typically due April 15 following the close of the calendar year. An extension for filing may be obtained until October 15, or beyond in special cases, of the year following the close of the calendar year. However, any tax due with the return must still be paid by April 15. The validly filed extension removes the late filing penalty for filing after April 15. However, if the tax return has a balance due, late payment penalty and interest will apply if the balance due is not paid by April 15. Taxpayers who plan to extend their tax returns past April 15 should prepare an estimate of their tax due at April 15 in order to pay the appropriate estimated tax due at that time.
3. **US income tax withholding does not equal tax due:** US income tax withholding on salary is based upon the number of withholding allowances an individual selects when they complete the US payroll withholding form (Form W-4). However, certain other payments may be subject to withholding at a flat rate, which may not equate to the taxpayer's final tax liability. The final US tax liability is determined once a tax return is prepared. Over-withholding is refunded by the tax authorities and under-withholding results in a balance due that should be paid with the filing of the tax return (or at April 15, as discussed above).



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4. **Individuals should be prepared to pay income tax in most of the states visited for work purposes:** Inbound taxpayers are often surprised that working in a state (even a state where they are not residing) may generate an additional state tax return filing requirement as well as a state income tax liability. In some cases, just one work day in a state can generate these requirements. Taxpayers' employers should track the individuals' travel to make sure proper reporting and withholding is undertaken and reported on the taxpayers' Forms W-2. Taxpayers should report the state sourced income on the relevant state tax return.
5. **Individuals will likely need to report, in various ways, foreign investment accounts:** There are complex and sometimes significant US reporting requirements for foreign bank and other investment accounts. If the value of these accounts is over certain thresholds, then disclosure of these accounts is required of all US taxpayers, with significant penalties for not complying. Examples of additional reporting includes the Report of Foreign Bank and Financial Accounts (FBAR), which is filed each June 30, if required, and Form 8938, Statement of Specified Foreign Financial Assets, which is attached to a Federal income tax return, where required. Individuals should consult a tax advisor regarding proper US reporting for their foreign accounts.
6. **The US has specific tax requirements associated with selling a home as well as loans denominated in foreign currency:** Selling a home, whether the property is based in the US or outside the US, may result in a taxable capital gain depending upon the time period of ownership and use as a principal residence. Additionally, US income tax may apply if a currency exchange rate gain occurs on the payment of a mortgage denominated in non-US currency. Before selling any property, but particularly before selling a property based outside the US, an individual should consult with a tax advisor to become aware of the potential tax implications connected with the sale, both from a US perspective and a home country perspective.
7. **The process of obtaining taxpayer identification numbers for a spouse/child is administratively burdensome:** In addition to the individual himself/herself, US tax law permits an individual to claim additional deductions for a spouse or other eligible dependent. In order to claim a dependency exemption for an eligible dependent on a US income tax return, the dependent will require a social security number or an individual taxpayer identification number (ITIN). In recent years the IRS has intensified the requirements surrounding requests for ITINs. To obtain an ITIN, the IRS generally requires original documentation of identification documents (e.g., passports) or copies of these documents that are certified by the issuing agency. Obtaining certified documents can be challenging, particularly for individuals who have already relocated to the US. Knowledge of these requirements before moving the US is helpful so copies of the requisite documents can be obtained before the move, if possible. These documents are submitted to the IRS with the first tax return filed by the taxpayer, or by visiting an IRS Taxpayer Assistance Center (TAC) to submit the original documents.
8. **Nannies, babysitters, cleaning ladies, and other similar helpers are considered household employees in the US and income paid to them may be reportable:** Hiring household employees, or even bringing household help to the US with the move, may result in reporting obligations and requirements to withhold and pay social security, Medicare, and unemployment tax (Federal and state). Taxpayers should consult with a tax advisor to determine the requirements based on the facts and circumstances of their household employees.


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9. **Residency for US income tax purposes is not the same as residency for US gift and estate tax purposes:** US income tax residency is determined based upon US status (i.e. citizen/green card holders) or days of US presence in the US. US residency for gift and estate tax purposes is based upon domicile. However, individuals who are deemed non-resident for US gift and estate tax purposes are still subject to these taxes on certain gifts and/or assets. Tax planning is available to plan for US estate and gift tax. Taxpayers should understand the US gift and estate tax implications of their residency status when in the US.
10. **Relinquishing a green card (permanent residency in the US) can create complex tax issues:** Many individuals apply for permanent residence status in the US if they plan to stay in the US indefinitely. Depending upon the time period an individual holds a green card, as well as additional tests surrounding net income tax and net worth, the individual may be liable for an exit tax upon relinquishing their green card. Any individual who has been in the US with a permanent resident status (i.e., green card) and then decides to leave the US and relinquish that green card should consult with a tax advisor to understand the potential tax implications of that action.

The above points summarize common issues inbound taxpayers are typically surprised to learn, in particular after they have arrived in the US and can no longer take actions to limit the tax. Taxpayers should be informed of the US Federal and applicable state tax rules prior to arrival in the US to avoid surprises and for efficient tax planning.

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## Permanent Establishment and Secondment Agreements – Challenges of Linking Corporate and Individual Tax Issues for Global Mobile Employees

In today's ever-changing global business arena, global mobility is increasingly common, whether in the form of formal expatriate arrangements or simply frequent international business travelers. Any type of cross-border employment or frequent travel can present a gauntlet of challenges such as immigration, cost management, individual and payroll tax compliance, relocation, and policy management. Because global mobility is often initiated by a business line or HR rather than by an employer's legal or tax departments, corporate tax issues are often an afterthought.

HR and mobility specialists know that having an employee perform services in more than one country can often trigger individual income taxes for the employee or additional payroll tax requirements for the company. But having an employee work in another country can also create exposure for the home-country entity from a *corporate tax* perspective. If an employee's activity in the host country creates a "permanent establishment" (a "PE") of the home-country entity in the host country, the employer may become subject to the host country's corporate tax on profits attributable to activity in the host country. In many circumstances, the individual's specific activities in the host country can have a significant impact on whether or not the home-


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country entity has a PE in that host country. If a PE has been created, local tax authorities may then assert that the home-country entity is liable for corporate taxes there. This can be a very costly and administratively burdensome situation for many companies.

Below, we look at the factors that taxing authorities may consider when evaluating whether a foreign multinational employer has created a permanent establishment in the United States ("US") – and is thereby subject to US corporate income tax. Then we look at ways to mitigate exposure to this risk, including the use of secondment agreements. We do not address other corporate tax implications, such as transfer pricing, recharge, and corporate deduction issues.

**Permanent Establishment (PE) evaluation**

**Check for treaty coverage:** What constitutes a PE depends on factors that vary by jurisdiction. As a first step, you should check whether an income tax treaty between the home and host countries provides specific guidance on what creates a PE. For example, the US model tax convention ("US Model Treaty") provides a broad-based definition of what does or does not constitute a PE for treaty partners. The primary factor is the existence of a "fixed place of business through which the business of an enterprise is wholly or partly carried on" when corporate activities go beyond "preparatory or auxiliary" activities. The most common fixed places of business include an office, factory, or workshop. The term "fixed" also implies a degree of permanence, and "place of business" is conditional on the existence of a facility or premises or even machinery or equipment where business is carried on. However, the US Model Treaty also includes provisions for construction works in progress which constitute a fixed place of business if the project or activity lasts for more than twelve months.

An employer can establish a PE if one of its employees "repeatedly" performs tasks that characterize the existence of a place of business in the host country. In some countries, courts have decided that twice is enough to establish "repetition." Less obvious circumstances may also fulfill the definition, such as maintaining a regularly available hotel room, a residence-based office, or an office location on site at a client.

**Authority to conclude contracts:** While a "fixed place of business" is certainly the primary factor used to define the existence of a PE in many treaties, other factors can come into play. The very activities of the individual who is working across borders can also constitute a PE. Persons whose activities may create a PE are called "dependent agents." Typically, individuals who have and habitually exercise the authority to negotiate or conclude contracts on behalf of their home-country entity can create a PE for that entity in the host country where they are performing their services. This is the case because the individuals are not acting independently; rather, they are acting at the home-country entity's direction.

A person is considered as authorized to negotiate or conclude contracts on behalf of a company in a host country if he or she is authorized to negotiate all elements and details of a contract in a way binding on the enterprise, even if someone outside the host country signs the contract. An agent who concludes contracts that bind the enterprise, even if those contracts are not actually in the enterprise's name, is not explicitly exempt from the definition of PE. Lack of active involvement by an enterprise in transactions may indicate a grant of authority to an agent. Additionally, the habitual exercise of an authority to conclude contracts related merely to auxiliary activities, which are merely tangentially related to the income generating activity of the


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employer (e.g., advertising, accounting services, etc.), will be insufficient to create a PE to the home-country entity.

For example, an agent may be considered to possess actual authority to conclude contracts where he or she solicits and receives (but does not formally finalize) orders that are sent directly to a warehouse from which goods are delivered and where the home enterprise routinely approves the transactions. In addition, tax authorities will scrutinize the relationship between the home-country entity and the individual to establish who bears the risk of the employee's activities and who provides the materials, equipment, or resources to perform the services.

**Objective definitions:** Some tax treaties define a PE specifically and objectively. For example, the United States – China income tax treaty specifies that a PE includes "the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for that purpose, but only where such activities continue (for the same or a connected project) within the country for a period or periods aggregating more than six months within any twelve month period." So if a Chinese employer has more than one employee in the US working on the same project, the Chinese entity must continually confirm that the employee's aggregate number of days of presence in the US does not exceed six months in a rolling twelve-month period – or the company will automatically create a PE in the US. Similar provisions appear in other treaties, including the United States' tax treaty with Canada.

Treaties can also specify activities treated as exceptions that would not give rise to a PE, even if a fixed place of business exists. Generally, the common feature of these activities is that they are "preparatory" or "auxiliary." For example, maintaining a fixed place of business solely for the purpose of gathering and distributing information, accounting, marketing, advertising, and market research often does not constitute the core business activity of a company and would not present the risk of establishing a PE.

If no treaty exists between the home and host country, then the host country's tax regulations will dictate whether specific actions by an employer will give rise to a PE. Under US federal income tax law, the presence of the employee of a home-country entity in the US can subject the home country entity to US branch profits or corporate income tax if the employee's actions are deemed to create a US trade or business and there is income earned which is effectively connected to that business. The determination of whether an employee's actions will create a taxable US presence focuses on the degree and significance of the activity of the employee in relation to the profit-making activity of the home-country entity. If the employee's activities rise to the level of a US trade or business, the income of the home-country entity which is effectively connected to the US trade or business could be subject to both US federal income tax on a *gross* basis and an additional tax on remittances of branch profits.


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When determining Permanent Establishment status, consider:

- Which entity is the legal employer of the employee?
- Where is the employee working?
- What kind of work is the employee performing in each location?
- How long will the employee be working in the US?
- Is company property from one country being used in another country?
- Which entities are benefitting from the services of the employee?
- Which entity or entities pay the employee's remuneration?

Can the employee negotiate or finalize contracts on behalf of the home entity?

**Mitigating exposure of a PE**

As discussed above, some cross-border employment activities can give rise to corporate tax exposure. What can you do to mitigate that risk – and educate the business leaders and global mobility specialists who are initiating international assignments? With the right tools and careful planning, you can structure foreign employment scenarios to keep from having the home-county employer inadvertently qualify as a PE in the US. However, cost-benefit analysis should always be undertaken to understand the true costs of a PE. In some cases, the presence of a PE is not an inherently bad outcome if, for example, income attributable to that PE is minimal or non-existent. In such cases, the cost of planning around a PE may be greater than the US tax cost associated with the activity.

In addition to the typical recommendations for avoiding/mitigating any PE exposure (for example, no fixed place of business, no signature of contracts locally, no negotiation to a point where the role of the home-country entity would be limited to a purely formal sign-off), several basic approaches can help:

1. **Monitor employee responsibilities:** It is prudent to restrict the ability/authority for assignees to negotiate and sign contracts and limit their responsibilities to those that do not provide the authority to make decisions that would bind the home-country entity either directly or indirectly. Assignees should instead take on advisory, consultative, and auxiliary roles.

   To mitigate the risk of creating a PE, the assigned employee should be removed as far as possible from any internal decision process of the home-country entity while working in the US when the process could result in a binding commitment for the company. If the


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employee must be involved in some decisions while working in the US, there should always be a supervisor outside of the US who can represent the company and who has the skill and authority to oversee the employee. The supervisor should always review the employee's opinions and approve (or reject) what the employee suggests or recommends.

2. **Use dual contract arrangements:** Historically, employers have used dual employment contracts not only to mitigate PE exposure but also to implement individual income tax planning. This scenario may prove effective if the employee plays dual roles for the company or is maintaining some home-country responsibilities while working in the host country in a specific capacity. A dual employment contract requires that the employee has a separate contract for each country employer. This can work only where the company has an existing employer in the host country. Then, it may be possible to segregate the employee's duties so that those that directly benefit the host country are covered under a local employment contract and any duties that benefit the home country are covered under a second agreement and not carried on in the host country. Note, though, that tax authorities are challenging these arrangements more frequently. They can be complex and may create additional risk. You should seek location-specific advice before pursuing dual employment contracts as a means to avoid PE status.

3. **Monitor frequent business travelers:** As noted above, some jurisdictions have specific timing thresholds that trigger PE. Often, these thresholds are based on the number of days that an employee or groups of employees spend in that country in connection with a specific activity. For example, the United States – Thailand tax treaty stipulates that a PE will be established if a Thailand resident company furnishes consultancy services in the US through its employees (or other personnel engaged by the Thai company) for 90 or more days within any 12-month period. So it is important not only to know the specific rules for each country where you have assignees, but also to develop a system to track and monitor these mobile employees scrupulously to keep from crossing PE thresholds accidentally.

4. **Use secondment agreements:** Secondment agreements are often an effective, efficient way to manage PE risk in cases where an employee is performing services in a host country that benefit the *host-country* employer.

   A secondment agreement involves the home-country employer, the host-country employer, and sometimes the employee. In this agreement, the terms of loaning the employee from the home-country entity to the host-country entity are detailed.

   While the employee may be a party to the agreement for various reasons, a secondment agreement is not an assignment letter and should not be used as one. It is customary for employers to give employees a separate assignment letter detailing the terms of a cross-border assignment. In many cases, a secondment agreement will involve only the two employing entities and can cover all employees who are on assignment to each jurisdiction.

   A secondment arrangement typically includes specific terms designed to prevent the employee from creating a permanent establishment for the home-country employer in


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the host country. The activities of the employee in the host country are "imputed" to the host- country employer; the host-country company supervises the employee's host-country activities. The host-country employer takes responsibility for local payroll reporting and withholding. But the home-country employer can retain long-term control over the employee (e.g. termination, salary level, etc.). In addition, the home-country employer may be able to continue to set the terms of the assignment, which could allow the employee to remain in his or her home-country benefit plans. Legal counsel should be consulted to confirm this arrangement.

It is important that payments due under the secondment agreement from the host entity to the home entity be limited to the actual costs incurred by the home-country employer, and that the payment arrangements be created as reimbursements (it may be possible to add an overhead charge in some locations). Otherwise, the host-country tax authorities could deem the home-country company to be in the business of "leasing" employees, and impute taxable profits to the home-country employer. Transfer pricing issues should also be reviewed.

In addition, to be effective, secondment agreements should be reviewed by both home-country and US tax specialists:

a. The home-country review should confirm that the employee has a strong enough connection to the home-country employer to continue the employment relationship.
b. The host-country review should confirm that the employee's activities in the US, as well as his or her relationship to the home-country employer, do not create a PE of the home-country employer in the US. The host-country team can also review payments under the agreement to determine whether they are deductible in the US, and confirm that no profit will be imputed in the arrangement.

**Reducing overall taxes**

Many of the planning opportunities to mitigate PE exposure for the employer may adversely affect assignees' individual income taxation. In many scenarios, individuals are exempt from taxation in the host country because they meet certain criteria under income tax treaties. One of the common criteria is that costs remain borne in the home country.

A secondment agreement normally shifts costs from the home country to the host country. In these circumstances, costs, benefits, and risks needs to be weighed to determine which is the better course of action for the parties involved. In many cases, the additional administrative burden and incremental individual income tax cost may be far less onerous than corporate tax exposure, and is clearly something that can be budgeted and planned for in advance.

Secondment agreements can be a great tool in managing corporate tax exposure in cross-border employment scenarios. Implementation is generally best when all relevant functions (Global Mobility, HR, Tax, Finance, Payroll, Legal) work together as a team.

In the current regulatory environment, where tax authorities may be seeking new sources of tax revenue, planning carefully to avoid PE status – whether using secondment agreements or


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not – will help manage risk and may also increase the benefit of having employees perform services in more than one location.

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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

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| November 4 | Dbrief Webcast: Understanding the Potential Value of Federal, Foreign, and State Credits and Incentives<br>View archive |
| November 10 | Dbrief Webcast: International Assignments and Corporate Tax: Expanded Enforcement May Cost You<br>View archive |
| November 20 | Dbrief Webcast: Global Tax and Treasury Strategy: A New Approach for Pursuing and Retaining Value in a Fast-Changing World<br>View archive |
| December 4 | Dbrief Webcast: M&A Update: Important Tax Issues and Opportunities to Consider<br>View archive |
| December 15 | Dbrief Webcast: Year-End Update and Hot Topics<br>View archive |
| December 17 | Dbrief Webcast: Tax Transformation for Mid-Market and Private Companies: Is Now the Time?<br>Register now |
| December 18 | Dbrief Webcast: Managing Intercompany Transactions: The Giant Risk No One May Own<br>Register now |

### Recent Tax Developments

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|---|---|
| September 23 | Treasury Anti-Inversion Notice<br>View alert |
| October 9 | BEPS Action Plan Item 13: The New Documentation Standard Implications for the Financial Services Industry<br>View alert |



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| November 3 | Multistate Tax Commission Hears From Firms on Transfer Pricing Project<br>View alert |
| November 4 | BEPS Action 7: Preventing the artificial avoidance of PE status<br>View alert |
| November 10 | Proposed modifications to transfer pricing guidelines relating to low value-adding intragroup services<br>View alert |
| November 14 | OECD Issues Discussion Draft on Low-Value-Adding Intragroup Services<br>View alert |
| November 24 | Final Regulations Address Gain Recognition Agreements and Other Cross-Border Transfer Reporting<br>View alert |

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