Japanese Services Group tax newsletter

Quarterly U.S. Tax Topics for Japanese Multinational Corporations

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Research Credit: ASC Elections Allowed on Amended Returns

On Tuesday June 3, 2014, the U.S. Treasury Department and the Internal Revenue Service ("IRS") issued temporary and proposed regulations (TD 9666 and REG-133495-13, which were published in the Federal Register on June 3, 2014) enhancing taxpayers' flexibility when claiming research tax credits by allowing alternative simplified credit ("ASC") elections to be made on amended income tax returns. Specifically, the temporary regulations allow taxpayers to elect the ASC determined under section 41(c)(5) — which takes into account only recent qualified research spending by the taxpayer and any other members of its controlled group — on an amended return for a tax year, provided that neither the taxpayer nor any member of its controlled group for that tax year has previously claimed the regular research credit for that same year. Although the temporary regulations generally apply to tax years ending on or after June 3, 2014, the effective-date provision expressly states that taxpayers may rely on the new rules to make an ASC election on an amended return filed before the period of limitations for assessment of tax has expired for the tax year the credit is determined. See Treas. Reg. § 1.41-9T(d). As a result, taxpayers generally will have the option of claiming the ASC on an amended return for one or more of its three years preceding the current tax year (as well as for any other year still under examination) so long as they have not previously claimed a regular credit on a return filed for that same year. Otherwise, for credits determined in closed tax years ending before June 3, 2014 (i.e., years for which the statute of limitations has already expired), the prior set of regulatory rules apply, which prohibited both ASC elections on amended returns and extensions of time to make late ASC elections under Treas. Reg. §301.9100-3.

FASB & IASB Issue Guidance on Revenue from Contracts with Customers

On May 28, 2014, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) issued their final standard on revenue from contracts with customers. The standard, issued as Accounting Standards Update (ASU) 2014-091 by the FASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The standard supersedes most current revenue recognition guidance, including industry-specific guidance.

Tax implications of the new ASU

Federal income tax law provides both general and specific rules for recognizing revenue on certain types of transactions (e.g., long-term contracts and arrangements that include advance payments for goods and services). These rules are often similar to the method a taxpayer uses for financial reporting purposes and, if so, the taxpayer employs the revenue recognition method it applies in maintaining its books and records — e.g., cash basis, U.S. Generally Accepted Accounting Principles (U.S. GAAP), International Financial Reporting Standards (IFRSs). Although the Internal Revenue Code (IRC) does not require entities to use any particular underlying financial accounting method to determine their taxable income (such as U.S. GAAP), entities must make appropriate adjustments (on Schedule M) to their financial accounting pretax income to determine taxable income under the IRC.

The ASU may change the timing of revenue recognition and, in some cases, the amount of revenue recognized for entities that maintain their books and records under U.S. GAAP or IFRSs. These changes may also affect taxable income. For example, under federal tax principles, income is generally recognized no later than when it is received. However, there are a few limited exceptions that allow a taxpayer to defer revenue recognition (one year or longer) for advance payments. Under one of these exceptions, a taxpayer can defer revenue recognition for advance payments for one year to the extent that the revenue is deferred under the method used for the taxpayer's applicable books and records.

The standard may affect the timing and measurement of revenue for certain contracts with advance payments and thus may accelerate revenue recognition for contracts with multiple performance obligations, which could have an impact on current taxable income.

In addition, a few of the concepts in the standard may give rise to or affect the measurement of certain temporary differences. These concepts include:

- Revenue recognition upon a transfer of control that results in changes in book revenue recognition, as well as related contract assets and contract liabilities.
- Potential changes in the timing of revenue recognition for contracts that include variable consideration or a significant financing component.

•Capitalization of certain costs incurred to obtain or fulfill a contract, some of which currently may be deductible for tax purposes.

The tax implications associated with implementing the standard will be based on an entity's specific facts and circumstances. Thus, it will be important for tax professionals to understand the broad-based financial reporting implications of the standard so that they can analyze the tax ramifications and facilitate the selection of any alternative tax accounting methods that may be available.

The following are a few questions for entities to consider in planning for the transition:

•Will potential changes to the timing or measurement of U.S. GAAP or IFRS revenue or expense recognition affect the timing of revenue or expense recognition for income tax purposes?

•If the financial statement modifications in revenue recognition methods under the standard are favorable and permissible for tax purposes, is an entity required to request a formal change in tax accounting method from the tax authorities?

•If the financial statement modifications are unfavorable or impermissible for tax purposes, will the entity need to maintain certain legacy U.S. GAAP or IFRS accounting method records (i.e., records in accordance with the historical revenue recognition method that will be superseded by the standard)?

•When the amount of revenue in a contract with multiple performance obligations is allocated to the separate performance obligations under the standard, are there specific contractual terms that may result in a difference between the allocations for tax and book accounting purposes?

•To the extent that tax accounting methods differ from financial reporting accounting methods, are there any new data or system requirements that need to be considered?

•Are there any cash tax implications related to foreign controlled entities that, for example, maintain statutory accounting records under IFRSs?

•If there is a cumulative adjustment to the opening balance upon adoption of the standard at a foreign operation, should the U.S.-based parent entity reassess its indefinite reinvestment assertion and reevaluate the amount of deferred tax liabilities established for the related outside basis difference, if any?

•What is the effect on a multinational entity's transfer pricing strategy, specifically when the transfer pricing is based on the amount of revenue recognized for financial reporting?

•Should there be a change in the financial statement presentation for sales taxes collected that are remitted to a tax authority on the basis of the principal-versus-agent guidance in the standard?

•Although the impact on state taxable income generally is the same as that on federal taxable income, what other state tax implications should an entity consider?

Stop Corporate Inversions Act of 2014

On May 20, 2014, House Ways and Means Committee Ranking Member Sander Levin (D-Mich.) introduced the "Stop Corporate Inversions Act of 2014." Similar legislation was introduced in the Senate by Senate Permanent

Subcommittee on Investigations Chairman Carl Levin (D- Mich.). Both bills would make changes to the anti-inversion rules in Internal Revenue Code section 7874.

One of the goals of the proposed legislation is to stem the tide of corporate inversion transactions involving US multinationals, in which a larger US company acquires a smaller non-US company but the legal ownership is structured so that the US company becomes a subsidiary of its non-US target. These transactions may lead to a reduction in the combined group's overall effective tax rate by introducing tax planning opportunities that were not previously available to the US acquirer. However, the bill would go much further than existing anti-inversion rules by potentially bringing within the scope of the rules non-US based multinationals that acquire a US company or business, regardless of how small the US target may be or whether the US target was purchased for cash. Considering the retroactive effective date of taxable years ending after May 8, 2014, this proposed legislation should be considered by any non-US based companies contemplating a US acquisition.

Under the proposed legislation, a non-US company could become an inverted domestic corporation without issuing any shares in an acquisition of a US company or business, inbound companies should be aware of these proposed rules. The prospects for the eventual passage of this legislation with a retroactive effective date are highly uncertain. However, tax executives of non-US companies may consider analyzing the potential impact of the proposed legislation if enacted and consider alerting the C-suite or other stakeholders of the possibility of falling under the proposed rules if they are eventually enacted.

If enacted, the recently proposed retroactive amendments to section 7874 could cause a foreign corporation to be treated as a US corporation if the management and control of the corporation's expanded affiliated group (EAG) which includes the entity occurs primarily within the United States and such EAG has significant domestic business activities. Although an exception may apply if the EAG conducts substantial business activities in the foreign parent company's jurisdiction, there would be no shareholder continuity test under this proposal. As such, even a full cash purchase of a domestic corporation or partnership (or the assets thereof) could trigger US corporate status for the foreign parent company as of the date of the acquisition. Given the possibility that this legislation could apply retroactively to acquisitions occurring after May 8, 2014, any non-US company contemplating an acquisition of a domestic entity or assets should consider the potential application of the above rules before undertaking the acquisition.

Individual Taxpayer Identification Numbers to Expire After Five-Years of Non-Use

On June 30, 2014, the Internal Revenue Service issued a new policy on the expiration of Individual Taxpayer Identification Numbers (ITINs). Under the new policy, all ITINs will be subject to expiration if not used on a tax return for five consecutive years. The IRS will not begin to deactivate ITINs under this new policy until 2016.

ITINs are issued by the U.S. government to people who are not eligible to obtain a Social Security Number (SSN). For many foreign nationals who come to the U.S. to work, this may include spouses or dependents who are not authorized to work in the U.S. and therefore ineligible for a SSN. Nevertheless, to be able to report these spouses and dependents on a tax return and claim a tax deduction for them, a taxpayer identification number is required. The ITIN is the number that is issued for these individuals.

Under the previous policy announced on November 29, 2012, the IRS indicated that all new ITINs issued after January 1, 2013 would be subject to expiration after five years regardless of use. Taxpayers who continued to need ITINs would have to reapply after the five-year expiration period. ITINs issued prior to January 1, 2013 were not subject to the five year expiration period, but the IRS reserved the right to revisit the expiration policy with respect to these ITINs.

Under the new policy, all ITINs, and not only ITINs issued after January 1, 2013, are potentially subject to expiration. However, this will only occur if the ITIN is not utilized on a US tax return for five consecutive years. If a taxpayer continues to file a U.S. tax return and uses the ITIN assigned to that person or dependent, the ITIN will remain in effect for as long as it is used.

To allow for a transition period, the IRS announced that the deactivation of ITINs under the new policy will not begin until 2016. Taxpayers whose ITINs have been deactivated will have to reapply using Form W-7 and follow the current documentation process.

Factor Presence Nexus Considerations for Inbound Companies

A growing trend in state taxation is the adoption of bright-line statutory nexus thresholds in determining what it means to be doing business or otherwise have nexus in a state for income or gross receipts tax purposes. In 2002 the Multistate Tax Commission (MTC) adopted a uniformity proposal regarding a bright-line statutory nexus for business activity taxes. Under the proposal, "substantial nexus" would be established if any of the following thresholds are exceeded during the tax period:

- $50,000 of property in the state;
- $50,000 of payroll in the state;
- $500,000 of sales in the state; or
- 25% of the entity's total property, payroll, or sales are in the state.

The model statute provides that the threshold property, payroll and sales amounts may be adjusted annually to reflect the cumulative percentage change in the consumer price index.

Some states that have adopted a factor presence nexus standard have included the threshold amounts proposed by the MTC (see the California Example discussed below), while others have implemented variations that utilize different threshold amounts, particularly with respect to sales activity within the state. For example, effective for taxable years beginning on or after January 1, 2015, the nexus standard for the New York franchise tax will be broadened so that corporations with sales of $1 million or more to New York customers during the taxable year will be subject to tax.

California Example

For tax years beginning on or after January 1, 2011, in addition to California's traditional definition of "doing business" as that of "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit" in the state, a taxpayer is "doing business" in California, and thus subject to the state's franchise tax, if any of four factors are satisfied, including bright-line statutory nexus thresholds based on specified amounts of property, payroll, or sales in the state. With respect to sales, for tax years beginning on or after January 1, 2011, the threshold is whether the taxpayer's sales in California exceed the lesser of $500,000 or 25% of the taxpayer's total sales. The sales threshold is indexed for subsequent tax years, so that for taxable years beginning on or after January 1, 2012, the threshold is $509,500, while for taxable years beginning on or after January 1, 2013, the threshold is $518,162.

Considerations for Inbound Companies

As a result of these tax law changes, foreign companies may potentially be at higher risk of exposure to the franchise tax in California; similar considerations would exist in other states with bright-line statutory nexus thresholds. Foreign companies with US inbound activities may wish to consider the following hypothetical scenarios, each of which may require further analysis regarding whether a California franchise tax filing requirement and liability may exist:

- A foreign company generates licensing or royalty revenue from California use of intangible property such as patents, trademarks, licenses, royalties, internet games, etc. or from the sale of goods into the California market that incorporate such intangible property under a licensing arrangement with the product manufacturer (e.g., marketing intangible).
- Executives or employees of a foreign company travel to California to perform services for the benefit of the foreign company's US affiliates or customers.
- Executives or employees of a foreign company perform services outside the US and charge their California affiliates or customers for such services.
- A foreign company sells tangible personal property into California to a US affiliate or to a third party.
- A foreign company generates interest income on loans to its California affiliates or customers.

Various State Tax Developments

California Competes Tax Credit Application Dates Announced

The California Competes Tax Credit ("CCTC") is an income tax credit available to businesses expanding in or relocating to California. The CCTC was enacted on July 11, 2013, with the initial application period having closed on April 14, 2014. For fiscal year 2013/2014, the CCTC Committee awarded $28,904,663 in tax credits in amounts ranging from $20,000 to $6,000,000 to 29 taxpayers. For fiscal year 2014/2015, the Governor's Office of Business and Economic Development ("GO-Biz") anticipates $150,000,000 in available CCTC. Two of the three application periods and all CCTC committee hearing dates have been released by GO-Biz, and the application process should open shortly.

For fiscal year 2014/2015, funding will far exceed that available in the prior fiscal year. GO-Biz intends to conduct three funding rounds with approximately $150,000,000 of CCTC available. GO-Biz has announced the following application periods for fiscal year 2014/2015:

Application Period	Funds Available	Hearing Date
TBD – but likely Oct./Nov. 2014	$45,000,000	January 15, 2015
January 5, 2015 – February 2, 2015	$75,000,000	April 16, 2015
March 9, 2015 – April 6, 2015	$30,000,000 (plus any remaining unallocated amounts)	June 18, 2015

Louisiana Establishes 2014 Amnesty Program Dates

On August 12, 2014, the Louisiana Department of Revenue ("LADOR") issued a press release, announcing additional details regarding the 2014 Louisiana Tax Amnesty Program ("Amnesty Program"). As specified by the LADOR, the Amnesty Program is scheduled to begin on October 15, 2014, at 12:01 AM and end November 14, 2014, at 11:59 PM. Taxpayers with outstanding unpaid tax liabilities that qualify under the amnesty program may want to consider participating in the program.

Rhode Island Enacts Significant Tax Reforms

On June 19, 2014, Rhode Island Governor Lincoln Chafee signed into law the fiscal 2015 Budget, Bill No. H 7133 SUB A as amended ("H.B. 7133"). The new law substantially modifies and reforms various aspects of the Rhode Island Tax Law, including the following:

- Requires water's edge combined reporting for members of a unitary group of affiliated business entities that are more than 50% commonly owned and controlled. Such combination may, by way of a five year binding election, be done on an affiliated group basis. Rhode Island passive investment companies with five or more full-time employees are excluded from combined reporting.
- Provides rules regarding the treatment of net operating losses and credits, including certain limitations.
- Repeals the related-party expense addback requirement.
- Repeals the franchise tax.
- Reduces the corporate income tax rate from 9% to 7%.
- Imposes the $500 minimum tax on S corporations.
- Adopts single-sales factor apportionment, with market-based sourcing for sales of other than tangible personal property. Each unitary business group member's receipts will be included without regard to whether the member has nexus in the state (i.e., the "Finnigan" approach).

Talk to us

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