

Back to Basics: Inbound Tax Planning

DC Bar Taxation Section

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Overview of U.S. Taxation of Foreign Persons

U.S. Taxation of Foreign Persons – Generally

- U.S. persons subject to tax on worldwide (U.S. and foreign source) income.
- Foreign persons subject to tax on only certain income.
 - Net-basis taxation of income effectively connected with U.S. trade or business.
 - Gross-basis taxation of U.S. source fixed or determinable, annual or periodical income.
- U.S. tax treaties potentially override taxation under domestic law.

Residence – Individuals

- U.S. person
 - U.S. citizen
 - Resident alien
 - Green card test – lawful permanent resident at any time during year and status not judicially or administratively revoked.
 - Substantial presence test – (1) ≥ 183 days in current year or (2) ≥ 31 days in current year and ≥ 183 days under three-year weighted formula (1, 1/3, 1/6).
 - Closer connection exception - < 183 days, tax home in foreign country, and closer connection to foreign country.
- Foreign person – alien that is not a U.S. resident.
- Treaty “tiebreaker” rules may apply in certain circumstances.

Residence – Business Entities and Trusts

- U.S. person
 - Domestic partnership or corporation – partnership or corporation organized under U.S./state law.
 - Domestic trust – trust subject to authority of U.S. court and fiduciaries controlling trust are U.S. persons.
- Foreign person
 - Foreign partnership or corporation – partnership or corporation that is not domestic.
 - Foreign trust – trust that is not domestic.

General Source Rules (§§ 861 – 863, 865)

- Interest – residence of payer, generally.
 - Exception for U.S. branch of foreign corporation.
 - Special rule for residence of foreign partnership.
- Dividends – residence of payer, generally.
 - Exception for foreign corporation with $\geq 25\%$ ECI.
- Service income – place where services performed.
 - De minimis exception – services by foreign individual (1) as employee of non-U.S. employer, (2) present in U.S. ≤ 90 days during year, and (3) $\leq \$3,000$.
- Rents/Royalties – place of use.
 - Application of place of use test can be unclear in case of intangible property.

General Source Rules

(§§ 861-863, 865)

- Gain on sale of real property – situs of property.
- Insurance income – generally location of risks.
- Guarantee fees – residence of payer of fee.
- Non-specified types of income – analogize to specified types.

General Source Rules

(§§ 861-863, 865)

- Gain on sale of non-inventory personal property and intangible property – residence of seller.
 - Special “residence” rules.
 - Exception for sale of goodwill – place where goodwill was generated.
- Gain on sale of inventory.
 - Place of sale (title passage) for pure distributor.
 - Apportioned between place of manufacture and place of sale for manufacturer/distributor.
 - 50/50 default.
 - Election to apportion based on independent factory price.
- Exception for sales attributable to U.S. office or fixed place of business.

U.S. Trade or Business (“ToB”) – General Rules

- Generally not defined in Code or regulations.
- Case law suggests that activities within U.S. can constitute U.S. ToB if:
 - Considerable, continuous, and regular. *See, e.g., Pinchot v. Comm’r*, 113 F.2d 718 (2d Cir. 1940) (active management of leasing 11 rental buildings);
 - Non-passive; and
 - Income-generating (i.e., not ancillary to business).
- Generally requires exercise of business judgment in U.S.; ministerial activities not sufficient.

U.S. Trade or Business – Examples

- Running horse in race in U.S.? *See* Rev. Rul. 58-63 (concluding that taxpayer had U.S. ToB).
- Participating in boxing prize fight in U.S.? *See Johansson v. United States*, 336 F.2d 806 (5th Cir. 1964) (concluding that taxpayer had U.S. ToB).
- Isolated sales of products in U.S.? *See Pasquel v. Comm’r*, 12 T.C.M. 1431 (1953) (concluding that taxpayer did not have U.S. ToB).
- Triple net-lease of U.S. real estate? *See Neill v. Comm’r*, 46 B.T.A. 197 (1942) (concluding that taxpayer did not have U.S. ToB).
- Broadcasting targeting U.S. audience with revenue collection and mail received in U.S.? *See Piedras Negras v. Comm’r*, 43 B.T.A. 297 (1941) (concluding that taxpayer did not have U.S. ToB).

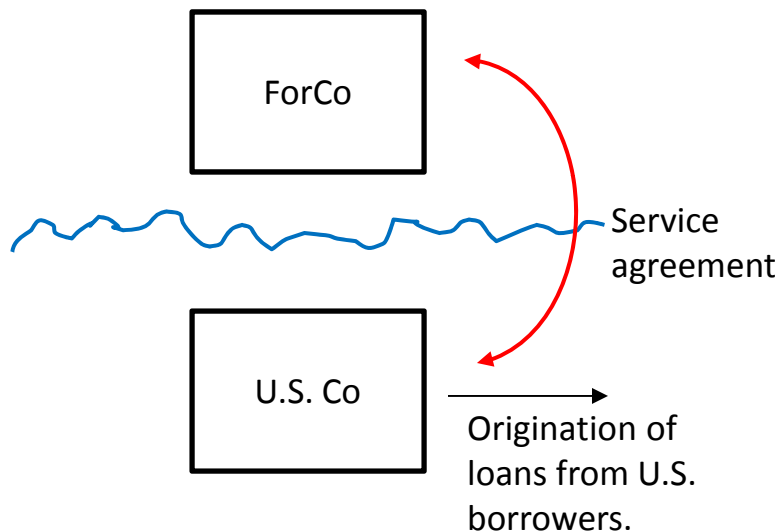
U.S. Trade or Business – Specific Statutory Rules

- Services performed in U.S. generally constitute U.S. ToB. § 864(b).
 - Personal services exception – performance of personal services in the U.S. by nonresident alien individual under certain circumstances is not a U.S. ToB where individual is present in the U.S. for no more than 90 days in the taxable year and compensation does not exceed \$3,000. § 864(b)(1).
- Dealer trading exception – trading stocks, securities, or commodities through U.S. broker (other than through dependent agent and other than through U.S. office or fixed place of business) is not a U.S. ToB. § 864(b)(2)(A), (B).
- Trading on own account exception – trading stocks, securities, or commodities for one's own account (regardless if through dependent agent) is not a U.S. ToB. § 864(b)(2)(A)(ii), (B)(ii).

U.S. Trade or Business – Activities Conducted Through Agent

- Activities of agents may be attributed for purposes of determining whether a foreign person has a U.S. ToB.
- Activities of employees and dependent agents generally attributed. *See, e.g.*, Rev. Rul. 70-424 (activities of exclusive selling agent are attributed).
- Activities of independent agents may also be attributed in certain circumstances. *See de Amodio v. Comm’r*, 34 T.C. 894 (1960), *aff’d* 299 F.2d 623 (3d Cir. 1962) (activities of independent real estate agents are attributed); Rev. Rul. 55-617 (sales activities through apparently independent agent are attributed).

U.S. Trade or Business – Lending Business Example

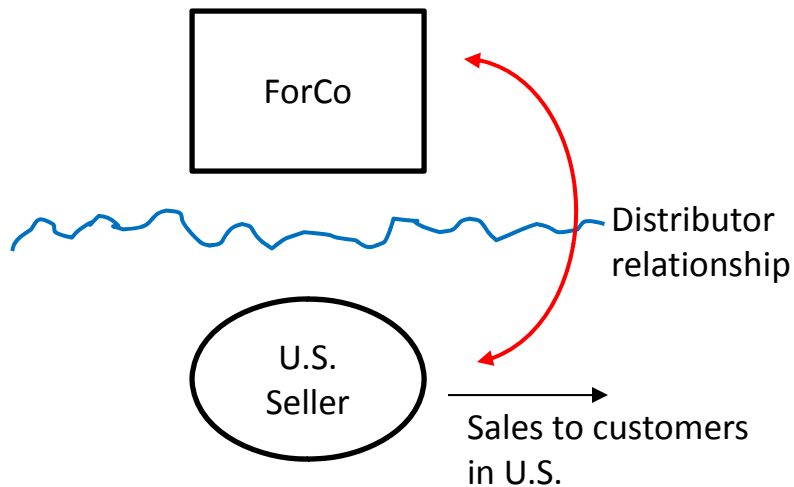


- ForCo does not itself conduct lending activities in U.S.
- Hires independent origination company to originate loans with respect to U.S. borrowers.
- Origination company:
 - Solicits borrowers.
 - Negotiates terms.
 - Does not conclude contracts.
- Does ForCo have U.S. ToB through activities of origination company? *See AM 2009-10* (finding existence of U.S. ToB even if origination company is independent).

Alternative Distribution Arrangements

- Distribute products directly.
 - Employees of foreign corporation as sales agents in U.S.
 - Independent sales agents in U.S.
- Distribute products through related distributor (e.g., subsidiary).
- Distribute products through independent distributor.
 - Buy-sell.
 - Sell on commission.

U.S. Trade or Business – Activities Conducted Through Agent



Factors

- Entrepreneurial risk (e.g., buy-sell v. commission-based fee).
- Required to purchase fixed amount of products.
- Return unsold products.
- Determine retail price.
- Discontinue sale of products.
- Conclude contracts without approval.

- ForCo does not itself conduct activities in U.S.
- Hires distributor to sell products in U.S.
- Does ForCo have U.S. ToB through activities of U.S. seller? *See, e.g., Hanfield v. Comm'r*, 23 T.C. 633 (1955).

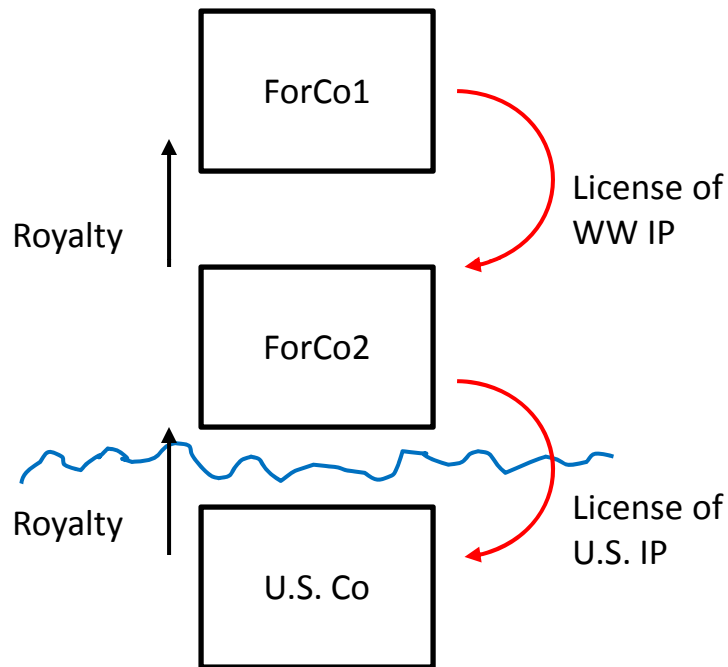
Effectively Connected Income (“ECI”)

- If a U.S. ToB exists, income effectively connected to that US ToB is taxed on a net basis at graduated rates.
 - Expenses allocated and apportioned to ECI.
- ECI includes:
 - FDAP-type income and capital gains. § 862(c)(2).
 - Income or gain derived from assets used or held for use in ordinary course of U.S. ToB (asset-use test).
 - U.S. ToB activities material factor in realization of income or gain.
 - Other U.S.-source income (limited force of attraction rule). § 862(c)(3).
 - Generally is ECI.
 - E.g., foreign manufacturer sells electronics in U.S. through fixed place of business, and also has vineyard and sells wine to U.S. distributor with title passing in U.S.
 - Foreign-source income. § 862(c)(4).
 - Generally not ECI.
 - ECI if attributable to U.S. office of fixed place of business under certain circumstances.
- ECI includes income even if arises in year U.S. ToB no longer exists (*e.g.*, deferred payments). § 864(c)(6).

Fixed or Determinable, Annual or Periodical (“FDAP”) Income

- 30% gross-basis tax (unless reduced by treaty) on U.S.-source FDAP income (and certain other types of income). § 881.
 - No deductions or other allowances.
- FDAP income
 - Includes interest (including OID), dividends, rents, royalties, salaries and wages, and other types of income.
 - Exception for portfolio interest.
 - Exceptions for interest on deposits in U.S. banks.
 - Excludes ECI.
 - Excludes gain from sale of property.
- Need not be periodic, can be one-time lump sum payment.
- Generally collected through withholding. §§ 1441 – 1442.

Cascading Royalties



- ForCo1 licenses worldwide rights, including U.S. rights, to IP to ForCo2.
- ForCo2 licenses U.S. rights to IP to U.S. Co.
- Is portion of royalty from ForCo2 to ForCo1 U.S. source and subject to FDAP taxation?
- *Compare* Rev. Rul. 80-362 (concluding royalties were U.S. source under § 861(a)(4)) *with SDI Netherlands* (concluding foreign person-to-foreign person royalties were not U.S. source).

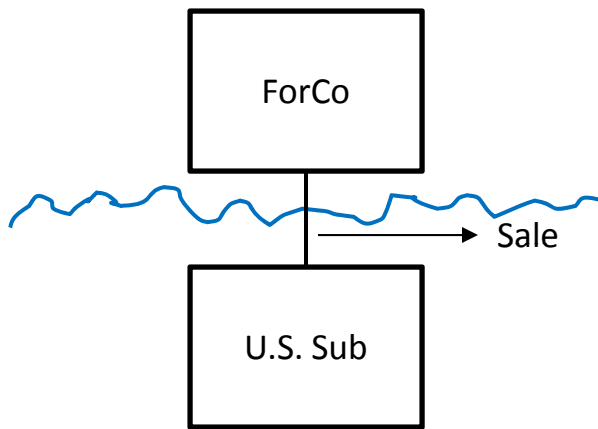
FIRPTA

- Prior to FIRPTA, gain on sale of U.S. real property by foreign person often not subject to U.S. tax.
- Under FIRPTA, gain on disposition of U.S. real property interest (USRPI) treated as ECI.
 - Gain on disposition of USRPI held directly.
 - Gain on disposition of stock of U.S. real property holding company (USRPHC).
- Not applicable to rental income.
- Collected through special withholding rules.

FIRPTA, Cont'd

- USRPI
 - Direct interest in land, building, chattel, fixture in U.S.
 - Indirect interest through partnership, trust, or estate.
 - Interest in domestic corporation that was USRPHC at any time in prior five years.
- USRPHC – domestic corporation if FMV of its USRPIs > 50% of FMV of its (1) USRPIs, (2) foreign real property interests, and (3) assets used in U.S. or foreign trade or business.

USRPHC – Example



U.S. building = \$200
Foreign building = \$50
Trade or business assets = \$50
Passive investments = \$200

- ForCo sells stock of U.S. Sub.
- FMV of USRPIs (\$200) > 50% of FMV of (i) USRPIs, (ii) foreign real estate, and (iii) trade or business assets (\$300), so U.S. Sub is USRPHC.
- Gain from sale of stock is ECI under FIRPTA rules, even if gain is not attributable to underlying USRPIs.

Tax Treaties – In General

- Intended to mitigate double taxation.
- Generally allocate taxing jurisdiction between source-state and residence-state (through credit or exemption system).
 - In inbound context, U.S. is source state and treaty partner is residence state.
- Relationship with U.S. domestic tax law:
 - Treaties generally on par with federal law, so can override U.S. domestic taxation of foreign persons.
 - U.S. domestic tax law can override treaties (e.g., § 894, Reg. § 1.881-3).
 - Later-in-time rule where treaty and U.S. domestic tax law conflict.
- Generally relevant only if taxpayer claims benefits under treaty.
 - Taxpayer is not required to apply treaty if taxpayer would be better off under U.S. domestic tax law.
 - Consistency requirement. *See, e.g.*, Rev. Rul. 84-17.
- Benefits generally available only to resident of treaty partner that satisfies one or more objective or subjective tests establishing sufficient nexus with residence state (Limitation on Benefits article).

Tax Treaties – Business Profits Attributable to a Permanent Establishment (“PE”)

- PE – Generally higher threshold for taxation than U.S. ToB.
 - Place of management, branch, office, factory, building site.
 - Generally does not include use for ancillary and preparatory activities such as storage, purchase, or delivery of goods.
 - PE deemed to exist if dependent agent habitually concludes contracts binding on taxpayer in the U.S., unless activities of dependent agent in U.S. are ancillary and preparatory.
 - No PE if taxpayer conducts business through independent agent acting in ordinary course of business.
- Business profits attributable to PE as if distinct and independent enterprise based on PE’s assets, risks assumed, and activities.

Tax Treaties – Reduced Withholding on Other U.S.-Source Payments

- Treaties reduce withholding tax rates on some U.S. source FDAP income, such as interest, dividends, and royalties.
- Generally lower withholding rates for interest and royalties than dividends.

Choice of Entity

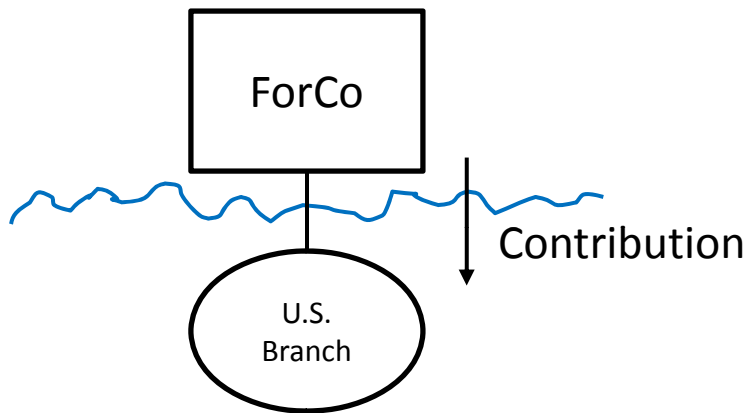
Choice of Entity – General

- Legal forms of business organization may include:
 - Branch
 - Partnership
 - Limited liability company
 - Corporation
 - Trust
- Legal form often not determinative of tax treatment.
 - “Check-the-box” elective classification rules. Reg. §§ 301.7701-1 to -3.
 - Eligible entities may elect out of default treatment.
 - Entities that are per se corporations not permitted to elect to be passthroughs.

Choice of Entity – General Considerations

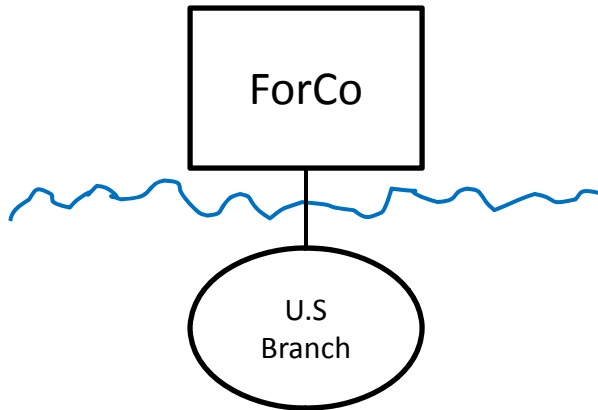
- What assets will be held in the business?
- What income will be earned?
- What subsequent business developments are expected?
 - Expectation of generating losses?
 - Later acquisitions?
 - Cash repatriation needs?
 - Expected sale of business?
- Location of investor
 - Treaty/non-treaty
 - Home country rules
- U.S. tax return filing requirements

U.S. Branch – Formation



- Essentially an extension of ForCo in the United States.
- May exist in variety of forms.
 - Informal operation of business in United States.
 - Entity (e.g., LLC) that elects to be disregarded for U.S. tax purposes.
- Formation is not taxable event for U.S. federal tax purposes.

U.S. Branch - Operation

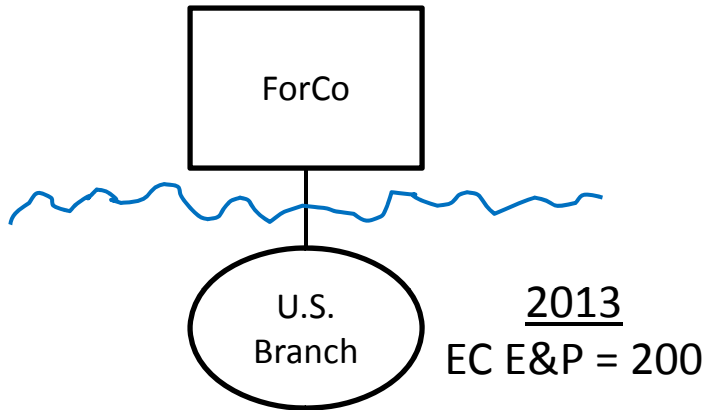


- Transactions between U.S. Branch and ForCo generally disregarded.
- U.S. Branch not subject to entity level taxation.
- ForCo taxed at U.S. corporate rates on income effectively connected to US ToB (or income allocable to PE).
 - ForCo must file a tax return to claim deductions and credits. *See* § 882(c)(2).
 - If no return is filed within the required time limit, a foreign corporation is subject to tax on gross, not net, income.
- Branch profits tax may apply (§ 884).
- A branch interest withholding tax (§ 884(f)(1)(A)) may apply.
- Often preferable if U.S. activities do not rise to level of U.S. ToB or U.S. PE.

Branch Profits Tax (§ 884)

- Intended to create parity between investment in U.S. by foreign corporation through domestic corporation and through branch (or foreign corporate subsidiary).
 - Two levels of tax if foreign corporation invests in U.S. through domestic subsidiary: (1) domestic subsidiary subject to US tax on worldwide income and (2) foreign corporation subject to U.S. withholding tax on dividends.
- Effectively a tax on profits remitted by U.S. branch.
- Applies only to foreign corporations, so a nonresident alien still can invest in U.S. through disregarded entity, branch, or partnership without incurring second level of tax.

Branch Profits Tax – Mechanics



<u>12/31/12</u>	<u>12/31/13</u>
U.S. Assets = 100	U.S. Assets = 120
U.S. Liabilities = 50	U.S. Liabilities = 50
U.S. Net Equity = 50	U.S. Net Equity = 70

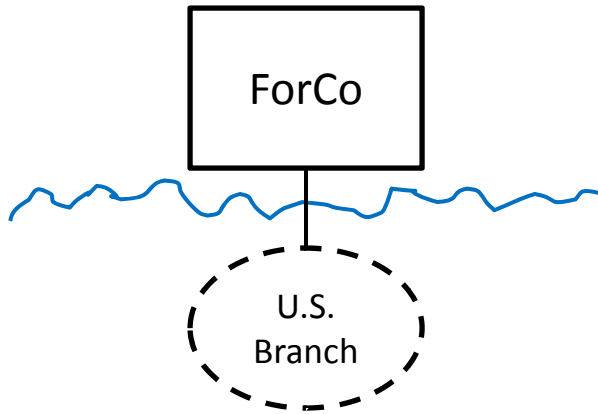
2013 BPT
 DEA = 180 (200 – 20)
 BPT = 54 (30% * 180)

- 30% tax on dividend equivalent amount (“DEA”).
- DEA = effectively connected E&P +/- increase/decrease in U.S. net equity.
 - Cannot be negative.
 - Limited to accumulated EC E&P.
- EC E&P is E&P attributable to ECI.
- U.S. NE equals U.S. assets (basis) minus U.S. liabilities.
- Effectively taxes branch earnings not reinvested in branch business assets, even if not repatriated.

Branch Level Interest Tax

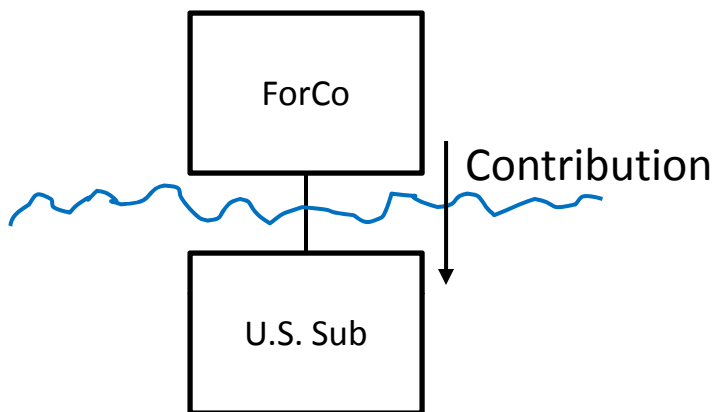
- Interest actually “paid by” U.S. ToB of foreign corporation treated as U.S. source. § 884(f)(1)(A).
- Excess of interest “allocable” to U.S. ToB over interest actually paid by U.S. ToB treated as U.S. source. § 884(f)(1)(B).
- Interest expense allocable U.S. ToB generally deductible against ECI. If treated as paid by foreign corporation (outside of U.S. ToB), then would be foreign source and might not be subject to U.S. taxation.
- Branch interest tax
 - If amount of interest allocated to ECI exceeds interest actually paid by U.S. ToB, excess is subject to branch interest tax.
 - Foreign corporation treated as if excess interest paid to it (foreign corporation) by wholly owned U.S. subsidiary, subject to U.S. withholding. Thus, branch interest tax imposed on notional base.

U.S. Branch – Termination



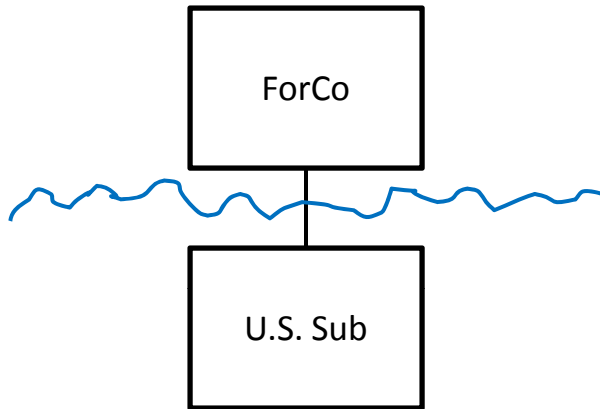
- No branch profits tax for taxable year in which branch completely terminates all of its U.S. trade or business activities if requirements in regulations are satisfied. Reg. § 1.884-2T(a)(1).
- Other considerations:
 - FIRPTA
 - Foreign exchange gain or loss

U.S. Corporation – Formation



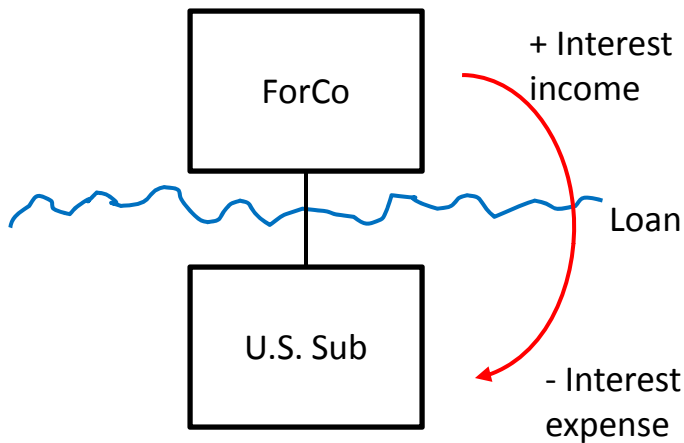
- Transfer of assets generally not taxable in U.S.
 - Generally eligible for nonrecognition treatment. § 351(a).
 - Even if ForCo recognizes gain, generally not subject to U.S. tax.
- U.S. Sub takes carryover basis in transferred property if transfer qualifies for nonrecognition. § 362(a).
- Often preferable if U.S. activities rise to level of a U.S. ToB or PE.
 - Avoids complications of branch profits tax.
 - ForCo not necessarily required to file U.S. tax return.

U.S. Corporation – Operation



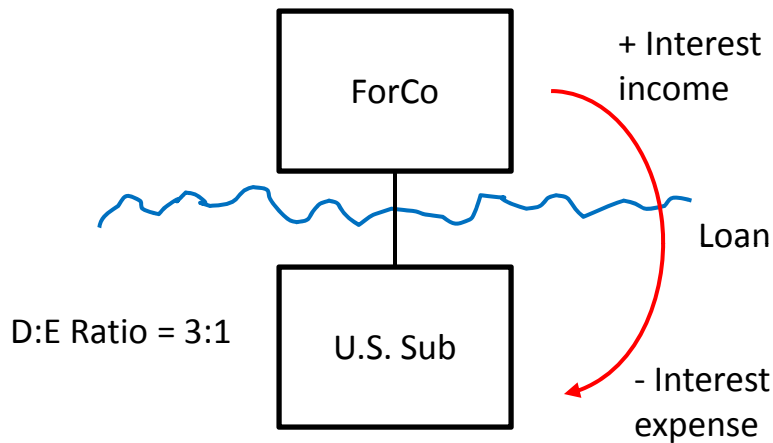
- U.S. Sub subject to U.S. corporate tax (generally 35%) on worldwide net income.
- U.S. Sub must file U.S. corporate tax return.
- Payments to related persons subject to transfer pricing rules (must be arm's length).
- Payments, such as dividends, interest, or royalties, to ForCo (and other foreign entities) are generally subject to 30% U.S. withholding tax unless reduced by tax treaty.

Earnings Stripping



- US. Sub earns income, subject to two levels of U.S. tax if distributed to foreign parent in form of dividend.
- ForCo could make loan to U.S. Sub.
 - U.S. Sub would deduct interest expense, reducing its taxable income.
 - ForCo subject to U.S. withholding tax on interest payments (but withholding tax rate may be reduced under treaty).
- Can occur through other intercompany arrangements, such as license from ForCo to U.S. Sub.

§ 163(j) Mechanics



Interest expense = 100

Interest income = 20

Net interest expense = 80 (100 – 20)

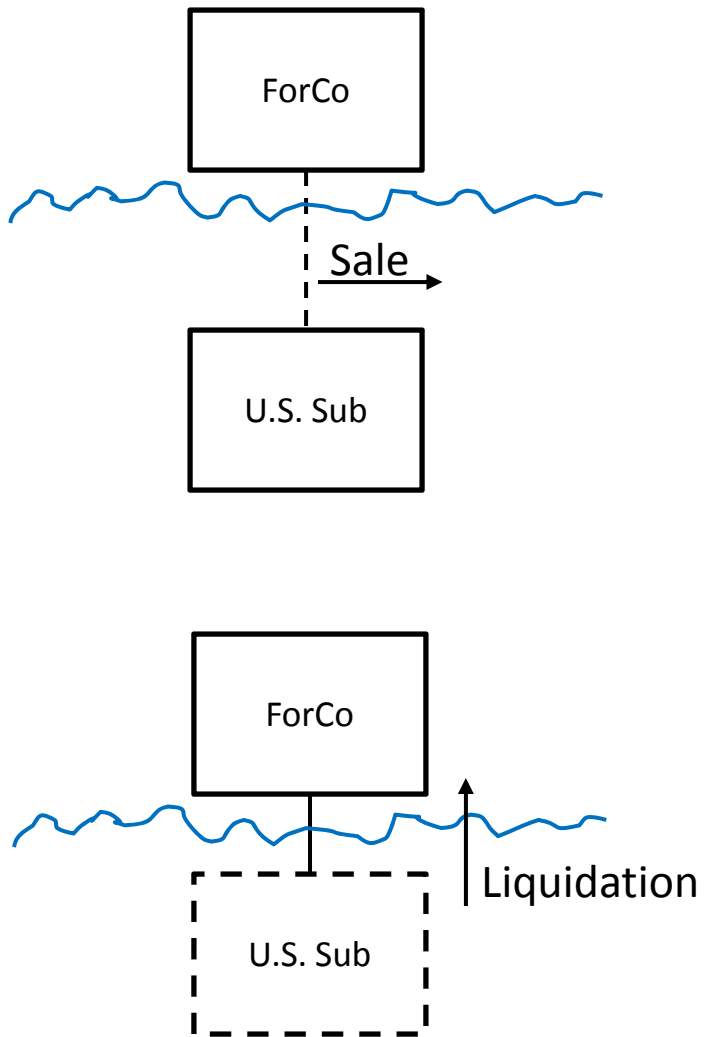
ATI = 100

Excess interest expense = 30 (80 – 50)

Disqualified interest expense = 30
(min (30, 100))

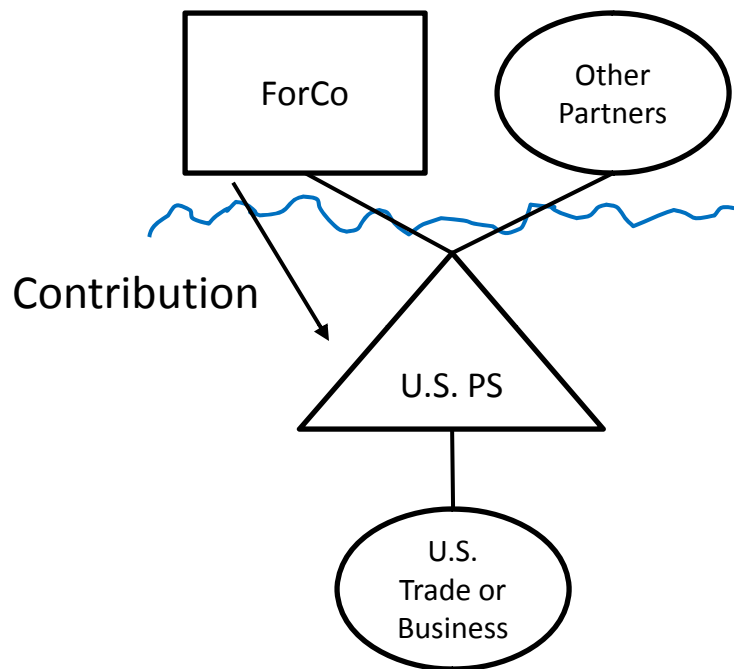
- If (1) U.S. Sub has excess interest expense and (2) U.S. Sub's D:E ratio > 1.5:1, U.S. Sub must defer deduction for disqualified interest expense.
 - Excess interest expense = net interest expense – (50% * adjusted taxable income)
- Disqualified interest is certain interest paid to related persons not subject to full U.S. tax (or unrelated persons if guaranteed by certain related persons).
- Disqualified interest expense is limited to excess interest expense.
- Disqualified interest expense is carried forward and can be deducted in a future year in which there is excess limitation.
 - Excess limitation = (50% * adjusted taxable income) – net interest expense
- Excess limitation can be carried forward three years.

U.S. Corporation – Termination



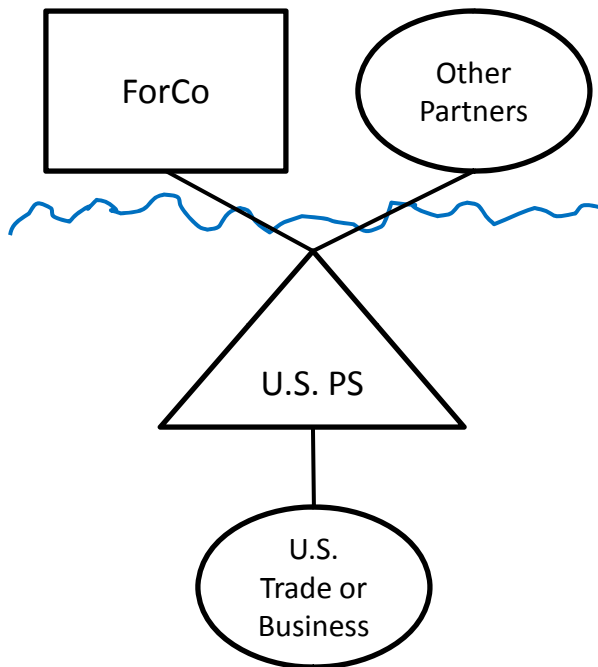
- Sale
 - Sale of stock of U.S. Sub generally not taxable in U.S. unless the stock is a U.S. real property interest (“USRPI”).
 - USRPI may include stock of a corporation that holds USRPI.
- Liquidation
 - Either actual corporate liquidation/dissolution or deemed liquidation pursuant to check-the-box election to treat U.S. Sub as passthrough entity.
 - U.S. Sub generally recognizes gain on the distribution of property in liquidation. § 367(e)(2).
 - Exception for assets used in a U.S. trade or business for 10 years if certain requirements are met. § 1.367(e)-2(b)(2)(i)(A)-(C).

U.S. Partnership – Formation



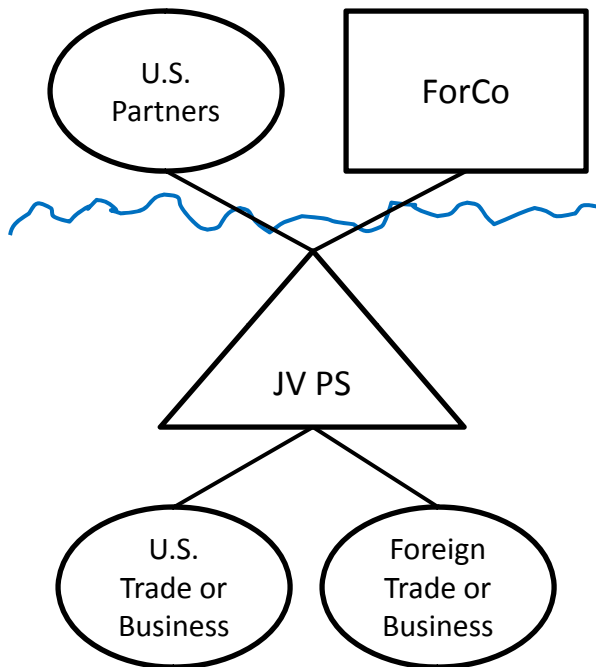
- Generally no U.S. tax on contribution of property. § 721.
- ForCo generally takes exchange basis in partnership interest. § 722.
- Partnership generally takes carryover basis in contributed property. § 723.

U.S. Partnership – Operation



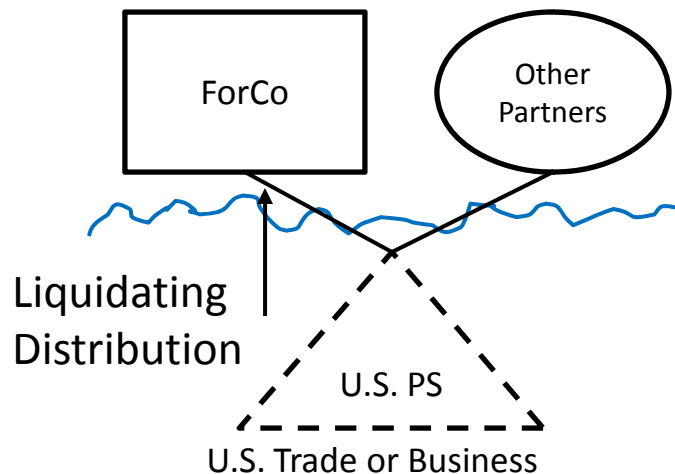
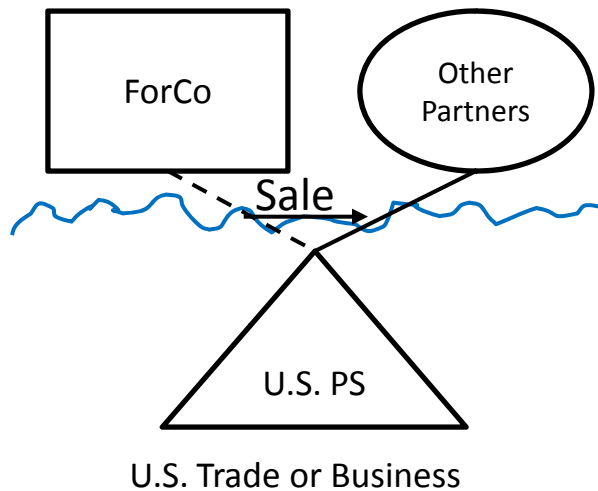
- Partnership itself not subject to U.S. tax.
- ForCo treated as operating a U.S. ToB by reason of the partnership's business operations. § 875(1).
 - ForCo taxed on ECI earned by partnership even if not distributed.
 - U.S. tax collected through special partnership withholding rules.
- Distributions from partnership to a partner is generally not taxable to the partner to the extent the distribution does not exceed the partner's basis in his partnership interest, subject to various exceptions. *See, e.g.,* §§ 731, 733, 704(c)(1)(B), 737, 751(b).
 - Interaction of partnership and international rules often uncertain.

International Joint Venture – Example



- ForCo enters into worldwide joint venture with U.S. partners.
 - Joint venture partnership conducts U.S. ToB and foreign ToB.
 - Can joint venture be structured to avoid causing ForCo from being treated as having a U.S. ToB or recognizing ECI?
 - Consider if under JV partnership agreement ForCo:
 - Does not share in income or loss from U.S. ToB.
 - Has no interests in U.S. ToB assets upon liquidation of JV partnership.
- See PLR 200832024 (providing foreign partner not treated as holding U.S. property for purposes of § 956).

U.S. Partnership – Termination



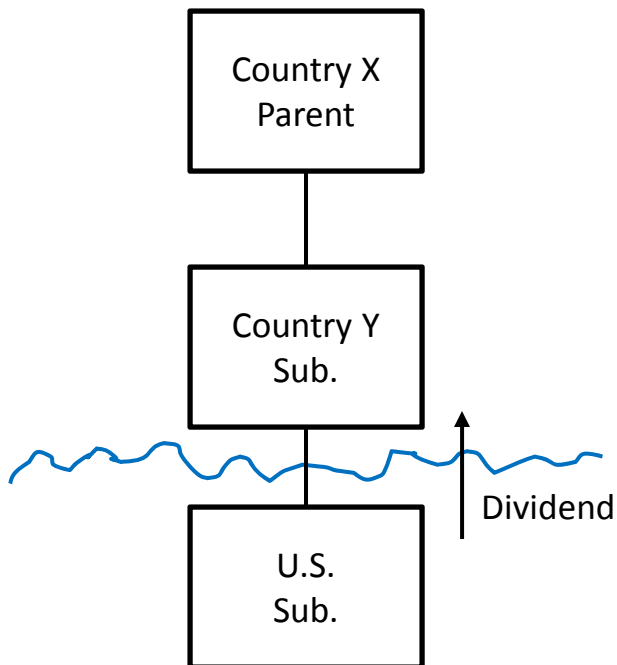
- Sale
 - Under Rev. Rul. 91-32, a foreign partner's gain from the disposition of a partnership that engages in a U.S. ToB may be sourced to the United States as ECI to the extent attributable to assets of the partnership used in a U.S. ToB.
 - The holding in Rev. Rul. 91-32 has been criticized on the grounds that the disposition of a partnership interest is generally treated as a disposition of an interest in an entity, not the underlying assets. Under § 741, the sale of a partnership interest is generally treated as a sale or exchange of a capital asset (subject to § 751).
 - The Obama Administration has proposed to codify Rev. Rul. 91-32.
- Termination
 - Partnership liquidation generally not taxable.

Investing Through Foreign Holding Company – Choice of Jurisdiction and Related Issues

Choice of Jurisdiction Considerations

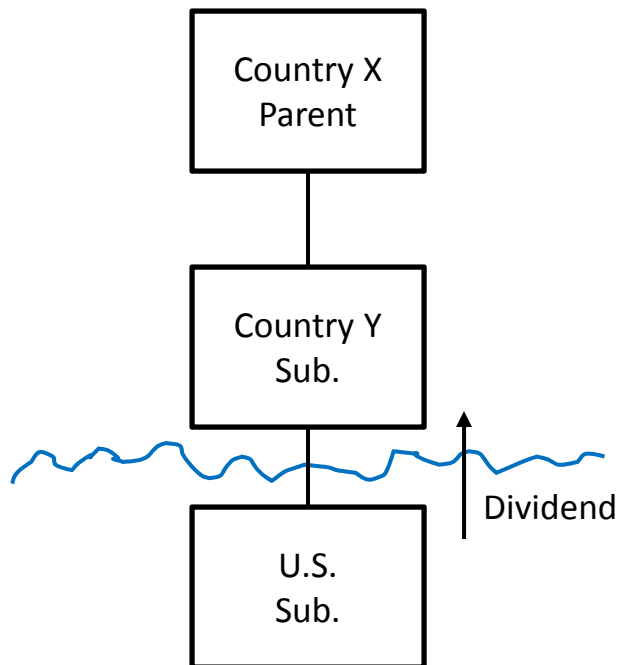
- Non-tax business considerations
- Non-U.S. tax considerations (entity-level tax, participation exemption, withholding taxes, non-U.S. tax treaties)
- Availability of U.S. tax treaty

Treaty Benefits



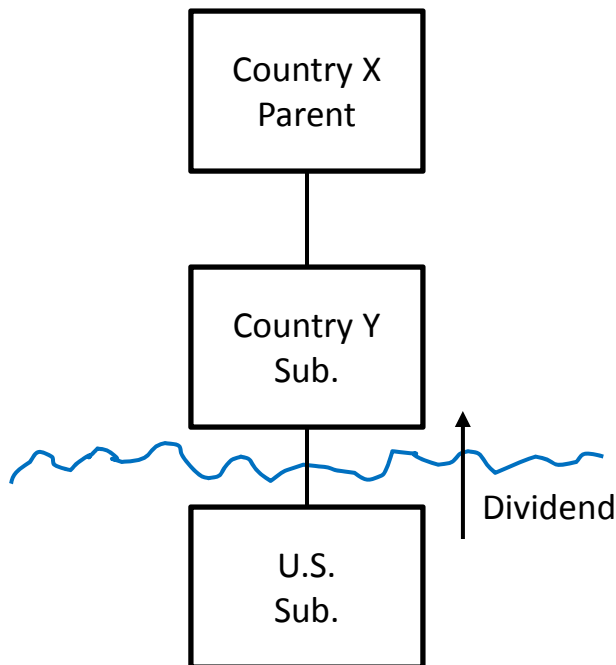
- Foreign parent organized in Country X.
- Foreign subsidiary organized in Country Y.
- U.S. subsidiary pays dividend to foreign subsidiary.
- Reduced withholding tax rate available under U.S.-Country Y treaty?

Limitation on Benefits, Generally



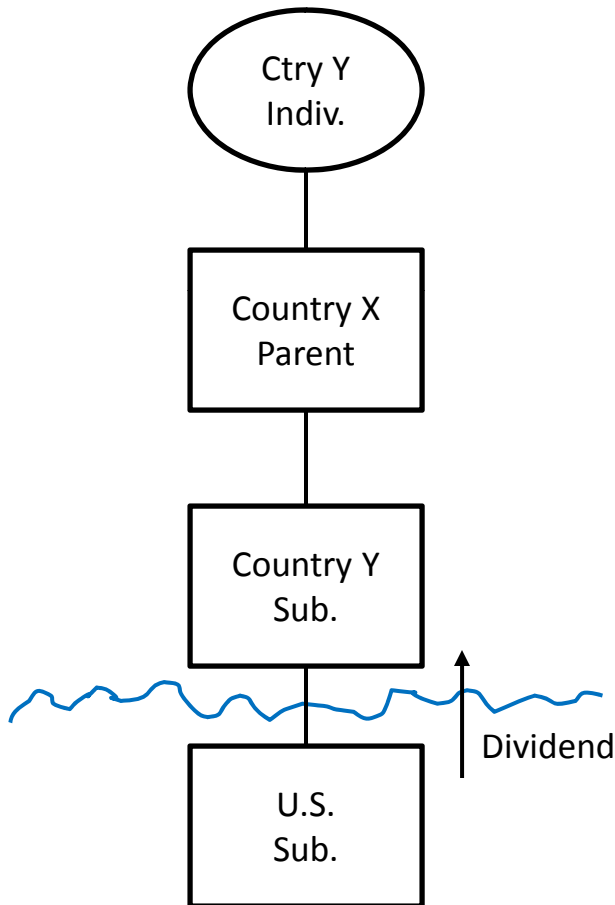
- Prevents treaty “shopping.”
- Objective tests (2006 U.S. Model)
 - Publicly-traded company test:
 - Principal class of shares and any disproportionate class of shares regularly traded on recognized exchanges, and
 - Principal class primarily traded on recognized exchange in residence state or primary place of management or control is in residence state.
 - Subsidiary of publicly-traded company test:
 - At least 50% of vote and value of shares and each disproportionate class of shares owned directly or indirectly by ≤ 5 companies satisfying publicly traded company test and intermediate entities are residents of either contracting state.

Limitation on Benefits, Generally, Cont'd



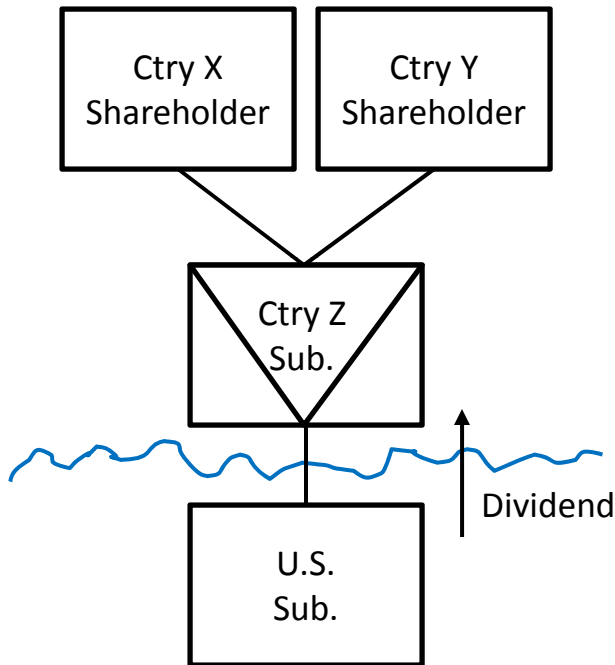
- Objective tests (2006 U.S. Model)
 - Ownership/base-erosion test:
 - At least 50% of vote and value of shares and each disproportionate class of shares owned directly or indirectly by certain qualifying residents of residence state and intermediate entities are residents of either contracting state, and
 - Less than 50% of gross income paid or accrued directly or indirectly as deductible payments to persons other than certain qualifying residents of either contracting state.
 - Active trade or business test (limited to certain income):
 - Active ToB in residence state (other than investing on own account) (applying certain attribution rules), and
 - Income derived in connection with, or is incidental to, trade or business .
- Objective tests in some treaties:
 - Derivative benefits
 - Headquarter company test (less common)
- Subjective discretionary test (2006 U.S. Model)
 - Competent authority discretion to grant benefits if it determines that establishment, acquisition, or maintenance of company and conduct of its operations did not have a principal purpose of obtaining benefits under treaty.

Limitation on Benefits – Application



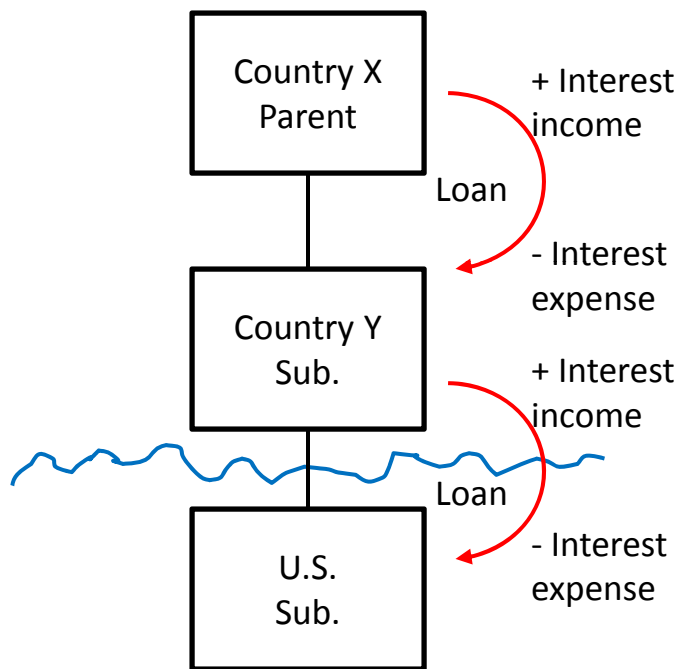
- Publicly-traded tests not satisfied.
 - Country Y Sub not publicly traded nor a subsidiary of a publicly traded company.
- Ownership/base-erosion test possibly satisfied.
 - Ownership test satisfied.
 - Base erosion?
- Active trade or business test possibly satisfied.

“Derived By” Requirement



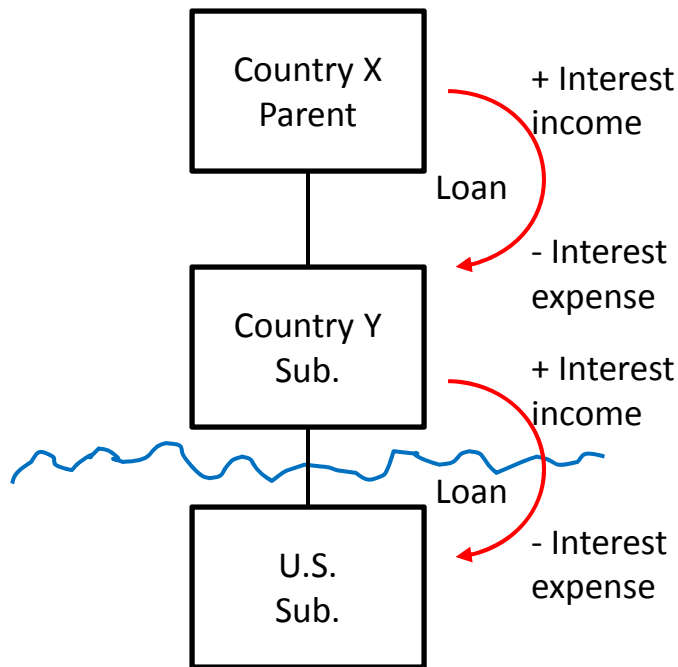
- U.S. has treaties with Countries X, Y, and Z.
- Country Z subsidiary fiscally regarded for U.S. tax purposes.
- Country Z subsidiary fiscally transparent (partnership) for Country Z tax purposes.
- Country Z subsidiary cannot claim benefits under U.S.-Country Z treaty. See § 894.
- Can Country X and Y shareholders claim benefits under US-Country X and US-Country Y treaties, respectively?

“Beneficial Ownership” Requirement - Conduit Arrangements



- US has tax treaty with Country Y but not Country X.
- Back-to-back loans.
- Can Country Y subsidiary claim reduced withholding on interest under U.S.-Country Y treaty?

Conduit Arrangements



- Factors under case law/rulings.
 - Spread on interest
 - Staggered terms
 - Fixed v. floating

See, e.g., Del Commercial Properties Inc. v. Comm’r, 251 F.3d 210 (D.C. Cir. 2001); *Northern Indiana Public Service Co. v. Comm’r*, 115 F.3d 506 (7th Cir. 1997).
- Conduit financing regulations can disregard intermediate entity acting as conduit. *See* Reg. 1.881-3.
 - Participation reduces withholding tax;
 - One of principal purposes of participation is tax avoidance; and
 - If intermediary unrelated, would not have participated but for financing entity engaging in financing transaction with such intermediary.

FATCA

FATCA Generally

- FATCA – common name of withholding and reporting provisions of Hiring Incentives to Restore Employment Act of 2010.
 - Final regulations released January 17, 2013.
- FATCA imposes withholding tax as a “stick” to encourage disclosure of U.S. account holders that may be evading U.S. tax through overseas accounts/entities.
- Beginning January 1, 2014, a withholding agent making a “withholdable payment” to a foreign financial institution (“FFI”) must withhold 30% unless that FFI has:
 - entered into an agreement with the IRS to identify and report its U.S. accountholders,
 - is organized in a country that entered into an intergovernmental agreement (“IGA”) with the United States, or
 - Otherwise falls within an excepted category.
- “Withholdable payment” includes U.S. source FDAP and gross proceeds from sales of U.S. assets.
 - Withholding on gross proceeds delayed until January 1, 2017.
- Withholdable payments made to nonfinancial foreign entities (“NFFEs”) are also subject to withholding unless the NFFE falls within an excepted category, certifies that it does not have substantial U.S. owners, or identifies its substantial U.S. owners.