



International Tax Developments Inbound Update

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I. Legislative/Statutory Updates



A. Suspension of Three Year Assessment Limitation

- HIRE Act modifies Code Section 6501(c)(8) by adding information categories
 - Statute of limitations will not expire before the date that is three years after the date the required information is furnished to the IRS
 - Suspension is not limited to adjustments solely on account of information to be reported but, if such information is required to be reported and would affect a return, it opens the entire return
- 2010 Education Jobs Act
 - If taxpayer can prove failure due to reasonable cause and not willful neglect, limitations period suspended only for items “related” to that failure
 - Applies to returns filed after March 18, 2010 and previously filed returns whose assessment period is still open at that date



B. Backup Withholding

- The backup withholding rate for 2010 was 28% and was set to increase to 31% after 2010
- The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “2010 Tax Relief Act”) extends the 28% rate through 2012



C. Economic Substance

- Code Section 7701(o) enacted – “codification” of the economic substance doctrine
 - Really a clarification
 - Economic substance is a conjunctive test:
 - transaction changes in a meaningful way the taxpayer’s economic position (other than tax effects); and
 - taxpayer has a substantial purpose for entering into such transaction
- Code Section 6662(b)(6) penalties
 - penalty equal to 20% of the portion of any underpayment of tax attributable to any disallowance of claimed tax benefits by reason of a transaction lacking economic substance is imposed
 - penalty increased to 40% of the portion of any underpayment attributable to a transaction that is found to lack economic substance and with respect to which the relevant facts affecting the tax treatment of the transaction are not adequately disclosed in the return or in a statement attached to the return



D. Interest and Dividend Substitutes

- Code Section 871(l) redesignated Code Section 871(m)
 - Code Section 871(m)(6) allows Secretary to reduce tax with respect to certain chain of dividend equivalents
- Notice 2010-46 withdraws Notice 97-66
 - Proposes new regulatory framework
 - Prior to September 14, 2010, taxpayers can rely on Notice 97-66 as modified by Notice 2010-46
 - After September 13, 2010 transition period whereby taxpayers can use transitional rules or implement proposed regulatory framework



E. 80/20 Companies

- 2010 Education Jobs Act repeals the rule that treats as foreign source income, all or any portion of any interest or dividends paid by a resident alien individual or U.S. corporation that meets the 80/20 test
- Under a special grandfathering exemption, however, the 30% withholding tax is not imposed on the active foreign business percentage of interest and dividend income paid by an existing 80/20 company as specifically provided in such exception



F. Guarantee Fees

- Under 2010 Small Business Act, Guarantee Fees now subject to specific sourcing rules
 - U.S. source income includes:
 - Amounts received, directly or indirectly, from a non-corporate resident or domestic corporation for the provision of a guarantee of any indebtedness of that resident or corporation
 - Amounts received from any foreign person for the provision of a guarantee of any indebtedness of such person, if those amounts are connected with income that is effectively connected (or treated as effectively connected) with the conduct of a U.S. trade or business
 - Any amounts received from a foreign person for the provision of a guarantee of indebtedness of that person, other than from U.S. sources described above, are income from foreign sources



G. Withholding Rate on Gains Passed Through from Sale of USRPI

- Withholding required under Section 1445(e)(1) at a rate of 35% for gains from sale of U.S. real property interest when such gains attributable to foreign persons
 - IRS granted regulatory authority to lower rate to 15% for amounts paid after May 28, 2003, but no regulations promulgated
 - Such authority was set to expire on December 31, 2010
 - The 2010 Tax Relief Act extends IRS authority to provide a 15% withholding rate for an additional two years



H. Withholding Tax Exemption for Certain Income Received from RICs

- Section 871(k)(1) excludes interest-related dividends received from a RIC from the 30% tax imposed by Section 871(a)(1)(A)
- Section 871(k)(2) excludes short-term capital gains dividends received from a RIC from the 30% tax imposed by Section 871(a)(1)(A)
- The 2010 Tax Relief Act extends the exemptions for such dividends paid in 2010 and 2011



I. RICs Included in Definition of Qualified Investment Entities

- A look through rule in Section 897(h)(1) requires that a “qualified investment entity” must generally withhold U.S. tax on a distributions to a foreign person or to another qualified investment entity to the extent it is attributable to gain from the disposition of a USRPI
 - Section 897(h)(4)(A)(i)(II) defined a RIC as a qualified investment entity if it is a United States real property holding corporation or would be if certain exceptions in the Code did not apply; this definition expired on December 31, 2009
- The 2010 Tax Relief Act retroactively restores the inclusion of RICs within the definition of qualified investment entities from January 1, 2010 through December 31, 2011



J. Look Through of Stock in a RIC in Determining Gross Estate of Nonresidents

- Section 2105(d) provides that the portion of the value of the stock in a RIC that is excluded from a nonresident noncitizen's gross estate is the portion of the value of the “qualifying assets” of the RIC to its total assets
 - “qualifying assets” are, generally, those assets that if owned directly by the decedent, would be excluded from the decedent’s estate, debt obligations not within in the U.S., and other property not within the U.S
- The 2010 Tax Relief Act extends this provision to the estates of decedents dying through 2011

K. Property Received from Non-Taxable Nonresident Decedent by a U.S. Beneficiary

- When a non-taxable nonresident dies in 2010 and property is received by a U.S. beneficiary
 - Under the 2010 Tax Relief Act, the U.S. beneficiary takes a basis step up to fair market value at date of death pursuant to § 1014.
 - Section 1014 applies by default, the personal representative does not have to make any election
- Before the 2010 Tax Relief Act was passed, the U.S. beneficiary would take a basis equal to the basis in the hands of the decedent pursuant to § 1022. Up to \$60,000 would then be allocable to the basis of the property received

II. Regulatory



A. Source of Income from Qualified Fails Charges (“QFCs”)

- Temporary Regulation § 1.863-10T, which is also text of the proposed regulation, establishes source rules for QFCs
 - Source for purposes of Sections 871 and 881
 - Generally, sourced to residence of recipient of the QFC
 - 2 exceptions
 - When QFC received by a non-U.S. qualified business unit (“QBU”) of a U.S. taxpayer, sourced to country where QBU is engaged in a trade or business
 - QFC is U.S. source if it arises from a transaction effectively connected to a U.S. trade or business
- Generally, QFCs result when one party fails to deliver Treasury securities by a specified time and has to pay an amount (a “fails charge”) to the party entitled to receive the securities
- Clarifies withholding requirements under Sections 1441 and 1442



B. Bank Deposit Interest Reporting for All Nonresident Aliens

- Under current Treasury Regulation § 1.6049-8(a), reporting of U.S. bank deposit interest is required only if the interest is paid to a U.S. person or nonresident alien individual who is a resident of Canada
- New proposed regulations promulgated in 2011 require information reporting for interest on deposits maintained at U.S. offices of certain financial institutions and paid to nonresident alien individuals who are residents of any foreign country
 - Will apply to payments made after December 31st of the year in which they are published as final regulations
 - Prior 2002 proposed regulations, which limited the reporting requirement to nonresident aliens of certain foreign countries, are withdrawn
- Treasury Regulation § 1.6049-6(e)(4) would be revised to provide that the payor or middleman can provide Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, to the recipient either in person or to the last known address of the recipient

III. Case Law



A. Compensation of Employees of Foreign Governments

- *Shoukrai Osman Saleh Abdel-Fattah v. Commissioner* 134 T.C. No.10
 - Code Section 893(a) only has three (3) requirements to exclude from U.S. source income:
 - Employee is not a citizen of the U.S. or is a citizen of the Philippines;
 - Services of a character similar to those performed by employees of the U.S. in foreign countries; and
 - In the case of an employee of a foreign government, the foreign government grants an equivalent exemption to employees of the government of the United States, performing similar services in such country
 - Secretary of State certification was not a “fourth” condition precedent or prerequisite for the exemption



B. Mutability Doctrine

- *Estate of Charania, et. al. v. Shulman*, 608 F.3d 67
 - Mutability - law of the country of domicile at the time of the acquisition of the property governs the questions of separate versus community property
 - Immutability - laws of the country of marriage apply (absent affirmative steps by the spouses to change the applicable law) to any later property acquisition regardless of where they are living when the property is acquired or whether their domicile changes
 - UK has a precedent of applying the doctrine of immutability
 - UK does not recognize community property
 - 100% of stock owned by decedent husband included in his gross estate



IV. IRS Revenue Procedures



A. Check the Box

- Revenue Procedure 2010-32
 - If qualified entity files valid Form 8832 to be classified as a partnership, but later determined that entity has a single owner, IRS will treat as election to be classified as a disregarded entity
 - If qualified entity files valid Form 8832 to be classified as a disregarded entity, but later determined that entity has two or more owners, IRS will treat as election to be classified as a partnership



B. Emigrants from Canada

- Revenue Procedure 2010-19
 - Guidance for individuals who emigrate from Canada with regard to an election for U.S. tax purposes under paragraph 7, Article XIII, of the Convention between the United States and Canada
 - Election procedure for taxpayers who emigrate to the U.S. from Canada on or after March 29, 2010
 - Election procedure for taxpayers who emigrate from Canada after September 17, 2000 and before March 29, 2010 and who are not time barred



V. IRS

Announcements/Advisory
Opinions/Private Letter
Rulings



A. Gift Tax Gross Up

- Chief Counsel Advisory 201020009
 - Inclusion of gift taxes paid by the decedent or his estate on any gift made by the decedent or his spouse during the 3-year period ending on the date of the decedent's death will not apply if the decedent is a nonresident for U.S. transfer tax purposes
 - While Code Section 2104(b) generally applies Code Sections 2035 through 2038 to estates of nonresidents, it only applies to property of which the decedent has made a gratuitous transfer
 - The payment of tax is not a gratuitous transfer within the meaning of Code Sections 2035 through 2038



B. Situs of Property

- Chief Counsel Advisory 201003013
 - Canadian resident, citizen and domiciliary, who at no time was a U.S. citizen or domiciliary, died owning a registered retirement savings plan (“RRSP”) that held Canadian mutual funds that held U.S. stocks
 - For purposes of determining the situs of property of the decedent, the RRSP did not affect that determination
 - Canadian mutual funds would be classified as corporations for U.S. tax purposes, even though they were formed as “trusts” under Canadian law - shares of the mutual funds do not constitute U.S. situs property since they were not interests in domestic corporations, even if the mutual funds invest in the U.S.



C. Uncertain Tax Positions

- Announcement 2010-9
 - Taxpayer required to disclose any position for which a tax reserve must be established under applicable accounting standards, including FIN 48
- Announcement 2010-30
 - IRS released, for comment, a draft of schedule UTP, Uncertain Tax Position Statement
 - Beginning with the 2010 tax year, certain corporate taxpayers with both uncertain tax positions, and assets equal to or exceeding \$10 million will be required to file Schedule UTP if they or a related party issued audited financial statements



C. Uncertain Tax Positions (cont.)

- Announcement 2010-76
 - If a document is otherwise privileged under the attorney-client privilege, the tax advice privilege in Code Section 7525, or the work product doctrine, and the document was provided to an independent auditor as part of an audit of the taxpayer's financial statements, IRS will not assert during an examination that privilege has been waived by the disclosure
 - Provided taxpayer does not engage in any act that would waive attorney-client privilege, tax-advice privilege, or workproduct
 - Provided no request for tax accrual workpapers is made under IRM 4.10.20.3 because unusual circumstances exist or the taxpayer has claimed the benefits of one or more listed transactions



C. Uncertain Tax Positions (cont.)

- Treasury Regulation § 1.6012-2(a)(4) – final regulation on reporting uncertain tax positions
 - Adopts proposed reg without change, except final reg applies to returns filed for tax years beginning on or after January 1, 2010.
 - Whereas proposed reg applied to returns filed for tax years beginning after December 15, 2009 and ending after the date the reg was published
 - Provides IRS with the underpinning for it to require affected corporations to attach to their returns Schedule UTP in accordance with IRS instructions



D. Discharge of Cross Border Debt

- Private Letter Ruling 201016048
 - Foreign parent purchased single share from domestic subsidiary in exchange for cancellation of debt equal to FMV of single share and canceled debt treated as capital contribution
 - Code Section 108(e)(6) – if debtor corporation acquires indebtedness from shareholder as contribution of capital, satisfied indebtedness with amount of money equal to shareholder's adjusted basis in indebtedness
 - Code Section 108(e)(8) – if debtor corporation transfers stock to creditor in satisfaction of debt, treated as satisfying debt in amount equal to FMV of stock
- Sometimes, structuring for foreign purposes potentially affects U.S. tax consequences



E. U.S. Continental Shelf Exploration Activities

- Chief Counsel Advisory 201027046
 - Remuneration for services performed by non-resident alien employees on structures permanently or temporarily attached to the U.S. outer continental shelf (“OCS”) or on vessels or other devices engaged in activities related to exploration/exploitation of natural resources on the OCS was subject to U.S. income tax withholding, FICA, and FUTA, because the services were performed within the United States
 - Certain employees may be subject to special treaty provisions