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CLIENT ALERT

Cryptocurrency in Small Bytes: Should You Set Up a Foreign Entity for Your ICO?

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We have previously written about some of the U.S. federal income tax consequences arising from participating in an ICO, whether as the issuer or an investor. The Tax Cuts & Jobs Act (TCJA), enacted in December 2017, may change some of these consequences. Before the TCJA, some startups formed non-U.S. companies to do an ICO, in the hope that the receipt of the ICO proceeds would not result in an immediate U.S. federal income tax liability. In general, whether a non-U.S. company is tax-efficient depends on the structure of the company, where the owners are located, and where the company is doing business. After the TCJA, there are additional tax considerations for a non-U.S. company undertaking an ICO. Moreover, companies that already used a non-U.S. subsidiary for an ICO may face a federal income tax liability this year.

Assuming the parent company is organized in the United States, a non-U.S. corporate subsidiary formed to issue tokens in an ICO will likely be a “controlled foreign corporation” (CFC) for federal income tax purposes. Certain income of a CFC (called “subpart F” income) is taxed currently to its U.S. owners, even if the income is not repatriated to the United States. Before 2018, ICO proceeds may not have been considered subpart F income to a U.S. parent company and thus may not have been subject to federal income tax until repatriated to the United States. Thus, a foreign subsidiary may have been used as a way to defer federal income tax on ICO proceeds.

Under the TCJA, a new category of income called global intangible low-taxed income (GILTI) is taxed in a manner similar to subpart F income. The GILTI provision imposes current U.S. tax on earnings of a CFC to the extent the CFC’s earnings exceed a fixed return on the CFC’s tangible assets. Depending on the operations of the group doing the ICO, it is possible that 100 percent of the ICO proceeds could be subject to GILTI tax.

On the other hand, companies that have already used foreign subsidiaries to raise money in an ICO may face a one-time tax charge in 2018, under a “deemed repatriation” provision of the TCJA. Generally, a U.S. shareholder of a CFC is required to include in income its share of a CFC’s undistributed earnings and profits as of December 31, 2017, to the extent such earnings and profits have not previously been taxed in the United States. As discussed in our previous alert, an ICO (unlike debt or equity financings) can give rise to earnings and profits. The rate of tax on the inclusion depends on the type of assets held by the CFC—generally, the rate is 15.5 percent for cash and certain other liquid assets and 8 percent for other assets. The liability can be paid over an eight-year period.

Companies that are planning to conduct an ICO should consider these new issues in evaluating the structure of the ICO, and companies that have already engaged in an ICO using a non-U.S. subsidiary should quantify any potential deemed repatriation tax liability.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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