The Inward Investment and International Taxation Review

Thirteenth Edition

Editor
Charles C Hwang

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THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW

THIRTEENTH EDITION

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PREFACE

I am pleased to bring to you the 13th edition of *The Inward Investment and International Tax Review*. This annual publication provides tax summaries for investment into 23 countries around the globe. While intended to provide readers with accurate and up-to-date analysis on the main tax considerations of investing in each of the jurisdictions covered, this publication is not a substitute for tax advice tailored to your unique circumstances.

From the onset of the covid-19 pandemic, governments around the world used their respective tax laws to help support their economies and raise the funds needed to provide this support. These support initiatives have ranged from robust government-backed loan programmes and individual stimulus payments to postponed tax deadlines and deferred tax payments. Some governments have largely ended these initiatives and now look to replenish their coffers or avoid further deficits, whether by increasing tax rates, increasing enforcement activities, or enacting altogether new taxes. Other governments continue to implement tax reduction policies to mitigate the negative impacts of the pandemic. For example, the Chinese government implemented a VAT credit refund, which will lead to an estimated 1.5 trillion yuan in total tax refunds, to improve businesses' cash flows. The Chinese government also implemented a 100 per cent super deduction for corporate basic research investments to promote corporate R&D. (By contrast, because of legislative inaction, the parallel US deduction for research expired and was replaced by a five-year amortisation rule (15 years for certain foreign research) effective for tax years beginning after 31 December 2021.)

Other themes were present before but have been brought to the forefront by the pandemic – namely remote work and global tax reform. Advances in technology continue to enable workers to perform their duties from anywhere in the world. Many of these workers do not realise the tax ramifications of remote work for themselves and their employers, and governments are stepping up their enforcement efforts. As for tax reform, the OECD continued making progress on its Two-Pillar Solution during 2022, but significant work still remains. The digitisation of the global economy continues, and until a global consensus is achieved on the OECD's Pillar 1, countries continue to pursue digital services taxes as a unilateral measure to protect their respective tax bases.

In 2022, the OECD made significant progress with its Pillar 2 15 per cent minimum tax project. In early 2022, the OECD released the commentary for the model rules for the 15 per cent tax. In February 2023, the OECD released administrative guidance related to the model rules. The effective tax rate in each jurisdiction in which a multinational group operates would be compared to the 15 per cent standard. To the extent that the 15 per cent minimum tax is not paid, a top-up tax equal to the shortfall would be paid to the jurisdiction of the ultimate parent of a multinational group that is within the scope of these rules. Each jurisdiction could choose to enact its own top-up tax. If such top-up tax conforms to the model rules, that tax would be creditable against the 15 per cent minimum tax assessed against the parent.

The United States has taken, to date at least, a different path from the OECD framework. The Inflation Reduction Act of 2022 was signed into law by the President on 16 August 2022. This Act provides for a number of tax credits and other policies aimed at bolstering energy and environmental policies as well as fostering investment in the United States. Prior to the Inflation Reduction Act of 2022, the United States had a minimum tax regime in the form of the base erosion and anti-abuse tax (BEAT). The Inflation Reduction Act introduced a second corporate minimum tax for large, publicly traded taxpayers. This new minimum tax is based on book income and is calculated as 15 per cent of adjusted financial statement income. Unfortunately, neither BEAT nor the new minimum tax on book income conforms to the OECD framework. Some of the United States' trading partners have also portrayed the tax credits enacted by this US legislation as being protectionist in effect.

The EU has enacted a new regime that extends the rules governing aid from EU governments (known as state aid) to non-EU governments as well. In June 2022, the European Parliament approved the Foreign Subsidy Regulation, which would require multinationals making an acquisition or forming a joint venture in the EU, or bidding on a government contract from a member of the EU, to disclose financial contributions from non-EU governments in certain circumstances. Tax benefits are included in the definition of financial contributions, though the mechanics of identifying and computing tax benefits are as yet unclear.

Governments also continue to enhance transparency in the beneficial ownership of private business entities and crack down on illicit finance. For example, beginning on 1 January 2024, new entities formed under US law, as well as foreign legal entities that register to do business with a state government or Native American tribe, will be required to register with the Financial Crimes Enforcement Network (FinCEN) (a bureau of the US Treasury Department with responsibility for enforcing US laws on money laundering, terrorist financing and other financial crimes). This registration will disclose all beneficial owners who directly or indirectly own or control 25 per cent or more of the equity of the entity or have substantial control over the entity. While there are a number of exemptions, such as for public companies and large operating entities, many expect the new beneficial ownership reporting rules to have a substantial effect on investment into the United States. Entities formed before 1 January 2024 will have until 1 January 2025 to also register. The database containing the information collected by FinCEN under these regulations is intended to be used only by law enforcement.

These are just a sample of the many developments that are discussed in the summaries that follow. I hope you find this updated guide helpful in following the current trends in taxation and the inward investment environment.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every effort has been made to ensure that the contents of this edition were current as of the date of publication.

Charles C Hwang
Washington, DC
February 2023

Chapter 22

UNITED STATES

Charles C Hwang and Eric Homsi[1]

I INTRODUCTION

Non-US investors have many decisions to make when starting a business in the United States, including with respect to the organisational form of the business. Whether a non-US investor decides to operate directly in the United States or to form a US subsidiary, the type and tax residence of the business entity chosen will dictate the scope of the US tax and return filing obligations to which the business (and the non-US investor) is subject. The right choices will depend on both tax and non-tax considerations, and will be informed by the business's purpose and ownership structure. US taxes may apply at the federal, state and local levels,[2] and understanding the relevant tax considerations from the outset can help to avoid unintended consequences.

Beginning on 1 January 2024, new entities formed under US law, as well as non-US legal entities that register to do business with a state government or Native American tribe, will be required to register with the Financial Crimes Enforcement Network (FinCEN) (a bureau of the US Treasury Department with responsibility for enforcing US laws on money laundering, terrorist financing and other financial crimes). This registration will disclose all beneficial owners who directly or indirectly own or control 25 per cent or more of the equity of the entity or have substantial control over the entity. While there are a number of exemptions, such as for public companies and large operating entities, we expect the new beneficial ownership reporting rules to have a substantial effect on investment into the United States. Entities formed before 1 January 2024 will have until 1 January 2025 to also register. The database containing the information collected by FinCEN under these regulations is intended to be used only by law enforcement.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

Non-US investors have a great deal of flexibility with respect to the organisational form through which they conduct business in the United States. A non-US person can conduct business in the United States through a non-US or US entity, and that entity can be organised as a corporation or a non-corporate entity (e.g., a general partnership, limited partnership or limited liability company). Regardless of the form chosen for corporate law

1 Charles C Hwang is a partner and Eric Homsi is a counsel at Crowell & Moring LLP. Unless otherwise indicated, all 'Section' and '§' references in this chapter are to the Internal Revenue Code of 1986, as amended (the Code), or to the Treasury regulations promulgated thereunder (the Treasury Regulations).

2 Except as addressed herein, a discussion of US state and local taxation is beyond the scope of this article.

purposes, however, from a tax perspective, the entity used generally will be considered either a corporation or a flow-through entity. The United States entity classification rules (also known as the 'check-the-box regulations') generally provide non-corporate entities with the ability to elect to be classified as a corporation or a flow-through entity for US federal income tax purposes.[3] A corporation is generally taxed at the entity level, with additional tax potentially imposed on the entity's owners when funds are distributed (or, in the case of a non-US corporation, a potential 'branch profits' tax, discussed below). A flow-through entity (e.g., a partnership or an entity treated as a 'branch' for US federal income tax purposes) is generally not subject to an entity-level tax, and the entity's income is taxed at the owner (partner) level. Accordingly, in choosing between different forms of investment, non-US investors should consider, among other factors, whether the entity will retain or distribute a significant portion of its earnings, the difference between corporate and individual income tax rates, and whether the business might qualify for tax credits or other incentives that may reduce the US tax cost of the business.

i Corporate

For US federal income tax purposes, an entity organised as a corporation under state law is generally subject to corporate-level taxation.[4] With respect to other entity forms, such as limited liability companies, the tax rules generally permit the entity to elect to be taxed as a corporation or a flow-through entity.

Inbound businesses, whether owned by individuals or a non-US entity, are often operated through a US corporation, or a US non-corporate entity that has elected to be taxed as a corporation. Operating through a US corporation offers a relatively simplified filing regime, in which the US corporation files an annual US income tax return and the non-US owners are generally not subject to a US income tax return filing obligation. However, if a non-US investor owns (directly or constructively) 25 per cent of the voting power or value of the US corporation, certain additional filing requirements apply. In general, many non-US persons prefer the relative simplicity that this filing regime provides, as opposed to the filing requirements that apply if a US trade or business is conducted directly through a branch or flow-through entity. A non-US corporation operating through a US corporate subsidiary will also insulate the non-US corporation from the complex branch profits tax (discussed below) applicable to non-US corporations operating in the US through an actual or deemed branch. In addition, only US corporations are eligible for certain deductions, such as a deduction for a portion of the corporation's foreign-derived intangible income (FDII). There can, however, be US withholding on dividends distributed by the US corporation to its non-US shareholders. Furthermore, certain inbound businesses, regardless of whether they operate through a US corporation or a branch or a flow-through entity, are subject to a minimum tax

3 Treas. Reg. § 301.7701-3. Certain other entities are treated as per se corporations for US federal income tax purposes, such as an insurance company or a state-chartered bank whose deposits are insured by the Federal Deposit Insurance Act or a similar federal statute. Treas. Reg. § 301.7701-2(b).

4 The Code provides for special types of corporations that are not subject to the general rule of entity-level corporate taxation. For example, certain qualifying corporations may elect to be classified as an 'S' corporation, which provides for flow-through tax treatment (i.e., no entity-level tax); however, S corporations are generally not available to non-US shareholders. Real estate investment trusts and regulated investment companies are also subject to special rules providing for entity-level taxation only to the extent their earnings are not distributed to shareholders. A discussion of the tax rules applicable to the special types of corporations is beyond the scope of this article.

on deductible payments to, and depreciation and amortisation of property purchased from, related non-US parties under the base erosion and anti-abuse tax (BEAT) discussed in more detail below.[5]

ii Non-corporate

A non-US person investing in or operating a business in the United States may choose to do so through a fiscally transparent entity (i.e., an entity not subject to entity-level taxation that passes through the results of its operations to its owners). Generally, for US federal income tax purposes, a non-corporate US entity with a single owner is disregarded as an entity separate from its owner (i.e., treated as a division or branch of its owner), and a non-corporate US entity with multiple owners is treated as a partnership. These entities, however, can generally elect to be classified as a corporation for US federal income tax purposes. The Treasury Regulations set forth the default classifications for US and non-US entities with either a single owner or multiple owners, and set forth the rules (and limitations) for adopting or changing an entity's classification for US federal income tax purposes.[6]

The non-US owner of a disregarded entity engaged in a US trade or business is treated as directly engaged in that US trade or business, and generally is subject to US taxation on its effectively connected income at the same rates applicable to a US person. Similarly, the non-US partners of a partnership engaged in the conduct of a US trade or business are treated as if they are directly engaged in a US trade or business, and generally are subject to US tax on their allocable share of partnership income (regardless of whether distributed) at the same rates applicable to US partners.[7] Generally, a partnership is obliged to withhold and pay over tax on a non-US partner's distributive share of effectively connected income at the maximum tax rate applicable to the person,[8] and the non-US partner must file a US income tax return reporting this income and paying the associated income taxes due (after claiming a credit for any withheld taxes).[9] Gain on the sale of an interest in a partnership that is engaged in a US trade or business is also subject to US tax, and the proceeds from this sale can be subject to US withholding.[10]

Certain industries, such as the banking industry, typically operate directly in the United States through a branch. The United States taxes the branch on all income that is effectively connected with its US trade or business, and, in certain cases, applies special rules in computing the tax base.[11] The United States also imposes a 30 per cent branch profits tax on dividend equivalent amounts,[12] which may be reduced or eliminated by treaty. The purpose of the branch profits tax is to equalise the tax treatment of the US operations of a non-US corporation with the treatment of US corporations owned by non-US persons. However, in practice, the branch profits tax does not always establish the intended parity in treatment between US branches and US subsidiaries.

5 Section 59A.
6 Treas. Reg. § 301.7701-3.
7 Section 864(c).
8 Section 1446.
9 Sections 33 and 6072.
10 Sections 864(c)(8) and 1446(f).
11 Section 882.
12 Section 884.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

The United States imposes tax on 'taxable income',[13] which is defined as gross income less allowable deductions.[14] Gross income is generally defined as income derived from any source, including gross receipts from the sale of goods and services (less cost of goods sold), rent, royalties, interest (other than interest that is exempt from taxation), dividends, gains from the sale of business and investment assets, and other items of income. Allowable deductions include those expenses that are ordinary and necessary to the conduct of the trade or business, such as salary and rental expenses of the business.[15] Other expenses that may be deducted, subject to certain limitations, include interest expenses, depreciation and amortisation, state and local income taxes, real estate taxes, certain losses and bad debts.[16] A non-US person engaged in business in the United States is generally entitled to the same wide range of ordinary and necessary deductions as a US person if this non-US person files US income tax returns.

Taxable income is not based on net income for financial accounting purposes, but instead on the method of accounting required by the Code and applicable Treasury Regulations. These methods include the cash receipts and disbursements method, the accrual method, special methods of accounting for certain items of income or deduction, or a hybrid method that combines elements of two or more of the foregoing methods. However, the overarching principle guiding a taxpayer's method of accounting is that it must clearly reflect income. If the Internal Revenue Service (IRS) determines that a taxpayer's method of accounting does not clearly reflect its income, the IRS may require the taxpayer to use a method of accounting that the IRS determines does clearly reflect income.[17] There are other limitations on taxpayers' ability to use certain methods of accounting. For example, for tax years beginning in 2023, corporations (and partnerships with a corporate partner) with average annual gross receipts exceeding US$29 million (based on a three-year lookback period and for subsequent years indexed for inflation) generally may not use the cash receipts method.[18] Accordingly, taxpayers should choose their methods of accounting intentionally, as once a taxpayer adopts a method of accounting, the taxpayer generally must obtain the consent of the IRS to change it.

US citizens and residents are generally taxed on worldwide income, while US corporations are generally taxed on a modified territorial basis. Non-US persons can be subject to US taxation on a gross basis (with respect to certain types of passive income, discussed below) or a net basis (with respect to income that is effectively connected with a US trade or business (ECI)).

13 Sections 1 and 11.
14 Section 63.
15 Section 162.
16 Sections 163-198.
17 Section 446.
18 Section 448 and Rev. Proc. 2022-38, 2022-45 I.R.B. 445.

Capital versus ordinary

For corporate taxpayers, there is generally no difference in the rate of tax applied to ordinary business income and capital gains. Non-US persons generally are not subject to US tax on capital gains;[19] however, exceptions to this general rule apply. For example, non-US persons are subject to US tax on gains related to US real property, including gains realised on an interest in certain US corporations that hold US real property, and gains realised in connection with a US trade or business, including gains realised on an interest in a partnership conducting a US trade or business.[20]

Losses

Net operating losses (NOLs) generally cannot be carried back but can generally be carried forward indefinitely, subject to the limitation that the NOLs used in a subsequent year cannot exceed 80 per cent of that year's taxable income.[21] The deductibility of NOLs may be further limited by certain ownership changes with respect to a corporation's stock aggregating to more than 50 per cent over a three-year period.[22] If such an ownership change occurs, the deductibility of the pre-change NOLs in future years is generally limited to an amount of income each year equal to the value of the target corporation immediately before the ownership change multiplied by the long-term tax-exempt rate of interest published by the IRS for the month of the ownership change.[23]

Unlike NOLs, capital losses can generally be carried back three years and forward five years,[24] and capital losses can only offset capital gains.[25] As a result of these limitations, taxpayers carrying forward capital losses may seek to accelerate capital gains to avoid having their capital losses expire unused.

Non-US persons conducting a trade or business in the United States must file an appropriate and timely tax return in the United States reporting any deductions, losses or credits to preserve their ability to use these deductions, losses or credits in future years.[26]

Rates

The federal corporate tax rate is currently a flat 21 per cent.[27] The BEAT imposes a minimum tax (in addition to any applicable income tax) equal to the excess of 10 per cent of the taxpayer's modified taxable income, less the taxpayer's regular tax liability and certain specified tax credits (but without reduction for any foreign tax credit). Modified taxable income is taxable income computed without regard to base erosion tax benefits (i.e., deductions for payments to related non-US parties or depreciation or amortisation deductions on property purchased from related non-US parties). The BEAT only applies to: (1) corporations, other than regulated investment companies, real estate investment trusts or S corporations; (2) with

19 *See* Section 865(a) (gains from the sale of personal property by a non-US person are generally treated as non-US source income).
20 Section 897 and 864.
21 Section 172. Exceptions apply for certain farming losses and NOLs of insurance companies. *Id.*
22 Section 382.
23 *Id.*
24 Section 1212.
25 Section 1211
26 Sections 874(a) and 882(c).
27 Section 11.

annual gross receipts of at least US$500 million for the three-year tax period ending with the preceding tax year; and (3) a base erosion percentage of 2–3 per cent. With certain limited exceptions, tax credits, including foreign tax credits, cannot be used to reduce the minimum tax due pursuant to the BEAT regime.[28]

The Inflation Reduction Act (IRA) (discussed further below) also imposes a new 15 per cent alternative minimum tax (AMT) on corporations, with average adjusted financial statement income (AFSI) in excess of US$1 billion effective for taxable years beginning after 31 December 2022. However, in the case of a multinational group with a non-US parent, this new minimum tax applies only if, in addition to the US$1 billion threshold, the AFSI of the US members of the group and the effectively connected AFSI of the non-US members of the group is at least $100 million.[29]

With respect to outbound payments of US-source passive investment income (e.g., dividends, interest, rent and royalties), the rate of US withholding tax is generally 30 per cent. This generally applicable rate of withholding may be reduced or eliminated under the Code[30] or an income tax treaty between the United States and the recipient's country of residence. If withholding applies but does not properly occur, the non-US recipient of the payment must file a US tax return and pay the appropriate tax, or else the payor of the income may be subject to withholding agent liability for the amount of the unpaid tax. Similarly, as discussed above, branch profits tax, if applicable, is also imposed at a rate of 30 per cent and may be reduced or eliminated under an applicable income tax treaty.

Administration

A US corporation must generally file its income tax return on or before the 15th day of the fourth month following the end of its taxable year, and an automatic six-month extension is available to those corporations that timely file an extension request by the original due date of its income tax return.[31] For example, a calendar year US corporation's income tax return is due on or before 15 April following the end of its taxable year, and the due date may be extended to the following 15 October. If a non-US corporation is required to file an income tax return, the due date for that return (or an extension request) depends on whether the non-US corporation maintains an office or place of business in the United States. A non-US corporation that maintains an office or place of business in the United States must generally file its income tax return on or before the 15th day of the fourth month following the end of its taxable year. A non-US corporation that does not maintain an office or place of business in the United States must generally file its income tax return by the 15th day of the sixth month following the end of its taxable year. An extension of time to file is available to non-US corporations that file an extension request on or before the due date of the tax return.[32]

28 Section 59A.

29 Section 55.

30 For example, the Code provides that certain portfolio interest may be entirely exempt from the generally applicable 30 per cent US withholding tax. Sections 871(h) and 881(c). This exemption for portfolio interest is discussed in more detail below.

31 Sections 6072 and 6081.

32 *Id.*

The tax owed for a taxable year must be paid on or before the due date of the tax return without regard to any extension of time for filing the income tax return. Furthermore, corporations must generally make quarterly estimated tax payments during the taxable year to avoid the imposition of underpayment interest and penalties.

US state and local jurisdictions may impose both income and non-income taxes, and the due dates for filing the applicable tax returns and paying the applicable taxes may differ from those for US federal income tax purposes.

Tax grouping

An affiliated group of US corporations may elect to file a consolidated income tax return.[33] Non-US corporations generally are not eligible to be included in an affiliated group filing a consolidated income tax return.[34] Affiliation is measured by stock ownership, and the common parent must directly own (by vote and value) at least 80 per cent of the stock of at least one subsidiary in the group, and each other subsidiary in the group must be at least 80 per cent directly owned (by vote and value) by one or more of the other members of the group. An election made by the common parent to file a consolidated income tax return applies to all corporations for which the ownership requirements are met. If such an election is made, the common parent files the US income tax return for the consolidated group.[35]

In general, a consolidated group determines its income tax liability by computing the separate taxable income of each member as if it were filing a separate income tax return. However, certain items of income and deductions are determined on a group basis, such as the consolidated NOL deduction.[36] Credits may also be available to offset the consolidated income tax liability.[37] Each member of the group is jointly and severally liable for the total income tax liability of the consolidated group.[38]

ii Other relevant taxes

US employers are subject to US federal payroll tax obligations and serve as withholding agents for their employees' payroll taxes.[39] US state and local jurisdictions may also impose payroll tax and withholding obligations on US employers. The United States does not impose a federal value added tax, goods and services taxes, or sales tax. Many US state and local jurisdictions may impose a sales tax on goods and certain services. These sales taxes are less expansive than a value added tax. The United States also does not impose stamp duty, capital duties, registration taxes or net wealth taxes.

33 Section 1501.
34 Sections 1504(b) and 1504(d).
35 Treas. Reg. § 1.1502-77.
36 Treas. Reg. §§ 1.1502-11, -21.
37 *E.g.*, Treas. Reg. §§ 1.1502-3, -4.
38 Treas. Reg. § 1.1502-6.
39 Sections 3102, 3111, and 3301.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

Tax residence in the United States is based on a corporation's place of incorporation, and not where it is managed or controlled. In some circumstances, a non-US corporation can elect to be treated as a US corporation.[40] In other circumstances, a non-US corporation may be deemed to be a US corporation, particularly when a non-US corporation has engaged in a cross-border business combination with a US corporation.[41]

ii Branch or permanent establishment

A non-US person will be considered to be engaged in a US trade or business if the non-US person conducts sufficient activities in the United States. The non-US person's income that is effectively connected with this US trade or business generally is subject to US taxation on a net basis.[42] There is no fixed threshold for when the activities of a non-US person will constitute a US trade or business, but a non-US person with regular, substantial and continuous activities, whether conducted directly or through agents, will be considered to be engaged in a US trade or business. Non-US corporations are also subject to a 30 per cent branch profits tax, which applies to dividend equivalent amounts that arise from actual or deemed distributions from the United States[43] and is subject to reduction or elimination under an applicable US income tax treaty.

If a non-US entity is a resident of a jurisdiction with which the United States has an income tax treaty, and this entity is eligible for benefits under the treaty, the entity will generally only be subject to tax on its business profits that are attributable to a US permanent establishment (PE) maintained by the non-US entity. The PE standard generally requires a non-US entity to have a greater nexus with the United States than is required to be considered engaged in a US trade or business. The relevant treaty and US law provide rules regarding the definition of a PE and, if a PE exists, the amount of income and expenses that are attributable to that PE and subject to US tax.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

As discussed above, an affiliated group of US corporations may join in filing a consolidated income tax return,[44] which will generally allows intra-group dividend distributions (and other transactions) to occur without current tax cost. The United States also provides a dividends received deduction (DRD) for certain other dividends received by a US corporate shareholder from a US corporation that are not part of the consolidated group. The amount of the DRD is 50 per cent in the case of dividends received from a US corporation that is owned up to 20 per cent. The DRD increases to 65 per cent in the case of dividends received

40 *See, e.g.*, Sections 953(d), 897(i), and 1504(d).

41 *See, e.g.*, Section 7874.

42 *See, e.g.*, Section 882.

43 Section 884.

44 Section 1501.

from a US corporation that is owned 20 per cent or more but less than 80 per cent. The DRD further increases to 100 per cent for dividends received from a US corporation that is more than 80 per cent owned but with which a consolidated income tax return is not filed.

While non-US corporations are generally not eligible to be included as members of an affiliated group filing a consolidated income tax return, the United States provides a 100 per cent DRD for the foreign-source portion of non-previously taxed dividends received from a specified 10 per cent owned foreign corporation.[45] The subpart F and the global intangible low-taxed income (GILTI) regimes, discussed further below, significantly reduce the benefit of this DRD by making a significant portion of a non-US subsidiary's earnings subject to current US taxation.

ii IP regimes

R&D expenditures must generally be capitalised and amortised over five years (or 15 years in the case of certain expenditures that are attributable to non-US research).[46] The United States also provides a credit for R&D expenditures that is generally equal to 20 per cent of the expenditures in excess of a base period amount determined by reference to a percentage of the taxpayer's average annual gross receipts for the preceding four taxable years.[47]

iii FDII

The United States provides US corporations with a lower tax rate (by way of a tax deduction) on its FDII. A US corporation's FDII is equal to the excess of its income earned selling certain goods and services or licensing or leasing property to non-US persons for use outside the United States over the corporation's deemed return on investments in tangible assets. Currently, a US corporation can deduct 37.5 per cent of its FDII, resulting in a 13.125 per cent effective tax rate on FDII. The deduction deceases to 21.875 per cent of FDII for tax years beginning after 2025, resulting in a 16.406 per cent effective tax rate during those years.[48]

iv General

The United States offers various business credits and other incentives (such as accelerated depreciation deductions for certain capital expenditures) to encourage investment in US business operations. As discussed further below, the IRA created or expanded tax credits to incentivise investment in certain green industries. US state and local jurisdictions may also offer incentives to encourage business operations within their respective jurisdictions. The availability of these incentives should be considered as part of any US investment strategy.

45 Section 245A.
46 Section 174.
47 Section 41.
48 Section 250.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME

i Withholding on outward-bound payments (domestic law)

A US person must generally withhold 30 per cent of the gross amount of certain US-source passive investment income (e.g., dividends, interest, rent and royalties) paid to non-US persons.[49] This statutory withholding rate, however, may be reduced or eliminated by statute or an applicable income tax treaty. Many US income treaties reduce the withholding tax rates on interest or royalties to zero. However, for certain taxpayers, the BEAT functionally disallows otherwise deductible payments to related non-US persons above a minimum percentage.[50] Many US income tax treaties also reduce the withholding tax on certain dividend distributions to zero if certain ownership and holding period requirements are met. Additionally, the US tax rules impose partnership-level withholding for each non-US partner's allocable share of effectively connected taxable income at a rate of 37 per cent for non-corporate non-US partners and 21 per cent for corporate non-US partners.[51]

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

The Code provides for exemptions from withholding on certain types of income to encourage certain types of economic activity. For example, interest on bank deposits that is not effectively connected with the conduct of a US trade or business is exempt from withholding.[52] Certain portfolio interest paid to non-US corporations and individuals is also exempt from withholding; however, this exemption does not apply to interest: paid to a 10 per cent shareholder of the payer and certain other related persons; paid to a controlled foreign corporation (CFC) that is a related person; paid to certain non-US banks; or paid on obligations that are not in registered form (e.g., bearer bonds). This exemption for portfolio interest also does not apply to contingent interest (i.e., interest determined by reference to sales, cash flow, income, profits, etc.).[53]

The Code also provides non-US sovereigns with certain exemptions from US taxation. The income of non-US sovereigns, including income received from US investments in stocks, bonds or other US securities, income from financial investments held in the execution of government, financial or monetary policy, or interest on deposits in US banks, is generally exempt from US federal income taxation.[54] This exemption, however, does not apply to income derived from any commercial activity, income received by or from a controlled commercial entity, or income derived from the disposition of an interest in a controlled commercial entity.[55]

iii Income tax treaties

The United States has income tax treaties with more than 60 partner countries around the world. Generally, these income tax treaties reduce the US withholding tax on dividends, interest and royalty payments to residents of a treaty country, provided that the beneficial owner of the income

49 Sections 1441 and 1442.
50 Section 59A.
51 Section 1446.
52 Sections 871(i) and 881(d).
53 Sections 871(h) and 881(c).
54 Section 892(a)(1).
55 Section 892(a)(2).

is a resident of the treaty country and meets any other eligibility requirements (e.g., the limitation on benefits article) of the applicable treaty. The withholding rates can vary by treaty and type of income, so the applicable treaty should be consulted to determine the withholding rate applicable to the payment at issue. However, the current US position in treaties negotiated with developed countries is to generally eliminate withholding on interest and royalty payments. And, with respect to dividends, the current US position in negotiating these treaties is to generally apply a 15 per cent withholding rate, which can be reduced to 5 per cent if the non-US shareholder holds at least 10 per cent of the US corporation paying the dividend, and which can be eliminated if the non-US shareholder holds at least 80 per cent of the US corporation paying the dividend.

The table below summarises the withholding rates applicable to dividend, interest and royalty payments under the income tax treaties concluded by the United States.

Domestic and generally applicable treaty rates for dividend, interest and royalty payments

	Dividends		**Interest**	**Royalties**
	Individuals, corporations	**Qualifying corporation***		
Domestic rates	%	%	%	%
Companies	30	30	0/30	30
Individual	30	N/A	0/30	30
Treaty rates	%	%	%	%
Armenia†	–	–	–	0
Australia	15	0‡/5	10	5
Austria	15	5	0	0/10
Azerbaijan†	–	–	–	0
Bangladesh	15	10	5/10	10
Barbados	15	5	5	5
Belarus†	–	–	–	0
Belgium	15	0‡/5	0	0
Bulgaria	10	5	5	5
Canada	15	5	0	0/10
China	10	10	10	7/10
Cyprus	15	5	10	0
Czech Republic	15	5	0	0/10
Denmark	15	0‡/5	0	0
Egypt	15	5	15	15/30
Estonia	15	5	10	5/10
Finland	15	0‡/5	0	0
France	15	0‡/5	0	0
Georgia†	–	–	–	0
Germany	15	0‡/5	0	0
Greece	–	–	0/30	0/30
Hungary	15	5	0	0
Iceland	15	5	0	0/5
India	25	15	15	10/15
Indonesia	15	10	10	10
Ireland	15	5	0	0
Israel	25	12.5	17.5	10/15
Italy	15	5	0/10	0/5/8

	Dividends		Interest	Royalties
	Individuals, corporations	Qualifying corporation*		
Treaty rates	%	%	%	%
Jamaica	15	10	12.5	10
Japan	10	0‡/5	0/10	0
Kazakhstan	15	5	10	10
Kyrgyzstan†	–	–	–	0
Latvia	15	5	10	5/10
Lithuania	15	5	10	5/10
Luxembourg	15	5	0	0
Malta	15	5	10	10
Mexico	10	0‡/5	15	10
Moldova†	–	–	–	0
Morocco	15	10	15	10
Netherlands	15	0‡/5	0	0
New Zealand	15	0‡/5	10	5
Norway	15	15	0	0
Pakistan	–	15	–	0
Philippines	25	20	15	15
Poland	15	5	0	10
Portugal	15	5	10	10
Romania	10	10	10	10/15
Russia	10	5	0	0
Slovakia	15	5	0	0/10
Slovenia	15	5	5	5
South Africa	15	5	0	0
South Korea	15	10	12	10/15
Spain	15	0‡/5	0/10	0
Sri Lanka	15	15	10	5/10
Sweden	15	0‡/5	0	0
Switzerland	15	5	0	0
Tajikistan†	–	–	–	0
Thailand	15	10	15	5/8/15
Trinidad and Tobago	–	–	–	0/15
Tunisia	20	14	15	10/15
Turkey	20	15	15	5/10
Turkmenistan†	–	–	–	0
Ukraine	15	5	0	10
United Kingdom	15	0‡/5	0	0
Uzbekistan†	–	–	–	0
Venezuela	15	5	10	5/10

* Generally, the lower non-zero rate applies if the corporate shareholder owns at least 10 per cent of the voting stock of the US corporation. The text of the treaty should be consulted as the treaty may provide for a different threshold.
† The treaty concluded between the United States and the former USSR.
‡ The zero per cent rate generally applies if the corporate shareholder owns 80 per cent or more of the voting stock of the US corporation for a 12-month period and qualifies under certain provisions of the limitation on benefits article of the treaty. The text of the treaty should be consulted.

iv Taxation on receipt

Non-US persons are generally allowed to claim a credit in the United States for the taxes paid to a non-US jurisdiction with respect to the income that is effectively connected with a US trade or business. This credit for non-US taxes, however, is not available: for any taxes paid to a non-US person's country of residence; with respect to any income that not effectively connected with a US trade or business; or to reduce the branch profits tax.[56]

v Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act (FATCA) is a reporting regime intended to combat tax evasion by US persons holding accounts and other financial assets offshore and imposes a withholding regime on certain US-source payments to foreign financial institutions (including investment funds) and certain other non-financial foreign entities. The FATCA withholding rate is 30 per cent.[57]

The United States has entered into agreements (intergovernmental agreements (IGAs)) with the competent authorities of other countries to facilitate the implementation of FATCA by reducing the burdens of compliance on foreign financial institutions and removing local legal restrictions on the sharing of information. As these IGAs may modify the statutory and regulatory provisions of FATCA, an applicable IGA should be consulted when determining a non-US person's obligations under FATCA.

VII TAXATION OF FUNDING STRUCTURES

Entities may be capitalised with equity or debt. US tax rules generally permit a deduction for interest payments made on indebtedness (discussed below), but do not permit a deduction on the distribution of a dividend or a return of capital. Regardless of the entity's form, contributions of cash or property when forming an entity are generally tax-free for the contributor and the receiving entity.[58]

i Characterisation of funding as equity or debt

The characterisation of an instrument as equity or debt for US federal income tax purposes generally depends on all the surrounding facts and circumstances. The Code does not contain a single defined set of standards for the purpose of distinguishing between equity and debt. Taxpayers generally rely on case law and certain published pronouncements of the IRS to guide them in making general debt-equity determinations. Courts and the IRS have articulated certain factors that are relevant in determining whether an investment, analysed based on its terms and economic characteristics, constitutes risk capital largely subject to the performance of the issuer's business (indicating that the instrument should be characterised as equity) or, alternatively, evidences characteristics of indebtedness that is expected, or may be compelled, to be repaid in full (indicating that the instrument should be characterised as debt).

The Treasury Regulations under Section 385 also address the characterisation of certain instruments as equity or debt. These Treasury Regulations address related-party debt instruments

56 Section 906.

57 Sections 1471-74.

58 *See, e.g.*, Sections 351 and 721.

issued by certain US issuers and generally operate to recharacterise such instruments as equity in certain situations. These situations relate to instruments that are issued in certain prohibited transactions, such as a distribution of the instrument to a related party, or treated as funding certain distributions to a related party.[59] Non-US persons establishing United States operations should be mindful that these Treasury Regulations can impact related-party debt instruments.

ii Thin capitalisation

The thin capitalisation rules of Section 163(j) have been replaced by a general limitation on the deductibility of interest (discussed below). However, a company's capitalisation remains a factor in determining whether an instrument is properly characterised as equity or debt for US federal income tax purposes. A high debt-to-equity ratio tends to indicate a level of risk undertaken by the instrument holder that, when coupled with other characteristics of an equity instrument, may be evidence of the parties having established more than a mere debtor-creditor relationship. There is no safe harbor debt-to-equity ratio at which debt will not be recharacterised as equity.

iii Deduction of finance costs and interest

Finance costs may generally be deducted by a US debtor, although certain rules may require that these costs be capitalised or deducted over the term of the financing.[60]

Business interest is deductible, but is generally limited to the sum of the taxpayer's business interest income, 30 per cent of the taxpayer's adjusted taxable income, and the taxpayer's floor plan financing interest. A taxpayer's adjusted taxable income is generally the taxpayer's taxable income with certain adjustments, including adjustments for business interest income or expenses, NOL deductions, capital loss deductions and deductions or losses not allocable to trade or business of the taxpayer. If a taxpayer has interest disallowed for a tax year as a result of these rules, this interest may be carried over to subsequent tax years, subject to the limitations applicable to these subsequent tax years.[61]

The deductibility of a taxpayer's business interest may be further limited if, for example, the interest is:

a paid with respect to certain acquisition indebtedness that is subordinated and convertible into equity, and the issuer's debt-to-equity ratio exceeds two-to-one, or projected earnings do not exceed three times the annual interest on the debt;[62]
b paid on certain high-yield obligations;[63]
c payable in equity of the issuer (or a related party) or equity held by the issuer (or a related party) in any other person;[64]
d paid or accrued by or to a hybrid entity or pursuant to a hybrid instrument and is a disqualified related party amount;[65] or
e related to indebtedness incurred to purchase tax-exempt obligations.[66]

59 Treas. Reg. §§ 1.385-1, -3, -4.
60 *E.g.*, Sections 263 and 263A.
61 Section 163(j).
62 Section 279.
63 Section 163(e)(5).
64 Section 163(l).
65 Section 267A.
66 Section 265.

iv Restrictions on payments

A corporation's ability to pay a dividend to its shareholders is governed by state, not US federal income tax, law. In general, a corporation needs to meet any applicable solvency requirements, take any necessary corporate governance actions, have permitted sources to pay the dividend (e.g., a balance sheet surplus or distributable net profits), and otherwise comply with applicable state law to pay a dividend to shareholders. However, the definition of a 'dividend' for state law purposes is not necessarily synonymous with the definition for US federal income tax purposes. For example, a distribution to shareholders could constitute a dividend under state law because it is paid out of surplus (as determined under state law principles), while it may not constitute a taxable dividend for US federal income tax purposes because the corporation has no earnings and profits (a tax concept that roughly corresponds with taxable income, subject to various adjustments).[67]

v Return of capital

Distributions by a US corporation to its shareholders generally constitute taxable dividends to the extent paid from the corporation's current or accumulated earnings and profits (as determined under US federal income tax principles). If a distribution exceeds the corporation's current and accumulated earnings and profits, the excess is treated first as a tax-free return of the shareholder's investment in the corporation's stock, and thereafter as capital gain, which is generally not taxable for a non-US person.[68]

The IRA also imposes a new 1 per cent excise tax on the repurchase of corporate stock by certain publicly traded corporations occurring after 31 December 2022.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

The taxable acquisition of a US corporation can be structured as a direct stock purchase or a reverse subsidiary cash merger. The reverse subsidiary cash merger is frequently the preferred structure, whereby the non-US acquiring corporation funds a transitory US subsidiary with equity and debt and merges this transitory subsidiary with and into the US target corporation, with the latter surviving. After the merger, the acquisition indebtedness resides with the US target corporation, providing a means to reduce the US tax base.

Generally, there is no US withholding tax upon the acquisition of a US corporation by a non-US entity. However, a 15 per cent withholding tax may apply to sale proceeds delivered to a seller unless the seller certifies to the acquirer that the seller is a US person or the US corporation certifies to the acquirer that it is not a US real property holding corporation.[69]

ii Reorganisation

The Code permits certain corporate reorganisations to be undertaken on a tax-free basis. Generally, these types of transactions include certain corporate mergers, stock acquisitions, asset acquisitions, and corporate spin-offs, split-offs and split-ups.[70] If a non-US corporation

67 Sections 312 and 316.

68 Sections 301(c) and 865.

69 Section 1445.

70 Sections 368 and 355.

acquires the stock or assets of a US corporation, there are several requirements that must be satisfied to avoid adverse US tax consequences. These requirements are focused on preventing an inversion, whereby the US corporation moves to a non-US jurisdiction with substantial continuity of its existing shareholder base, and, somewhat related, the loss of US taxing jurisdiction over corporate assets. The inversion rules are discussed further in the next section. If a transaction results in an inversion, the US shareholders or the US target could be subject to tax or, in certain cases, the non-US acquiring corporation could actually be treated as a US corporation for all US federal income tax purposes.[71] Reorganisations involving only non-US jurisdictions generally do not give rise to US tax, except in certain cases where there is significant (i.e., controlling) US ownership of the acquired or target non-US corporation before but not after the transaction.[72]

iii Exit

A non-US person generally is not subject to US federal income tax on capital gains resulting from the sale of stock of a: US corporation, except for certain US corporations that hold US real property; or a non-US corporation conducting a US trade or business.[73] However, a non-US person's disposition of assets used in a US trade or business, including through an interest in a partnership engaged in a US trade or business, will be subject to US federal income tax.[74]

If a non-US corporation acquires the stock or assets of a US corporation, the rules under Section 367 cause the gain of US shareholders on stock in a US corporation that is transferred to a non-US corporation to be subject to US taxation, unless several requirements are met. These requirements include that the non-US acquiring corporation be at least as valuable as the US target corporation and conduct an active non-US trade or business. Furthermore, a US parent corporation generally will recognise gains on assets that it transfers to a non-US acquiring corporation even if the transaction otherwise qualifies as a non-taxable asset reorganisation. For this reason, it is generally necessary to transfer the stock, rather than assets, of a US corporation that wishes to exit the United States.

The rules under Section 7874 apply at the entity level, and can treat a non-US acquiring corporation as a US corporation for all US federal income tax purposes if:

a the non-US acquiring corporation acquires substantially all the assets (either directly or through a stock acquisition) of the US target corporation (or substantially all the properties constituting a trade or business of a US partnership);

b at least 80 per cent of the stock of the non-US acquiring corporation is owned by former shareholders of the US target corporation (or US partnership) by reason of having owned the US target; and

c the non-US acquiring corporation's expanded affiliated group lacks substantial business activities in the jurisdiction in which the non-US parent corporation is incorporated.[75]

71 Sections 367(a) and 7874(b); Treas. Reg. § 1.367(a)-3(c).

72 Treas. Reg. § 1.367(b)-4.

73 Sections 865 and 897.

74 Sections 871(b), 882, and 864(c).

75 Section 7874. For there to be substantial business activities in a non-US jurisdiction, Treas. Reg. § 1.7874-3 requires at least 25 per cent of a non-US acquiring corporation's expanded affiliated group's

Alternatively, if the above requirements are satisfied but the ownership continuity is at least 60 per cent (but less than 80 per cent), then the non-US acquiring corporation is respected as a non-US corporation; however, the US target will not be able to use any tax attributes (such as losses or credits for non-US taxes) against any gain that the US target corporation recognises (or royalty income it receives from affiliates) by reason of property transfers during the 10 years that follow the inversion. A US corporation that undergoes such a 60 per cent inversion during the 10 years after 22 December 2017 may also have to increase its tax by an amount equal to the difference between 35 per cent and the actual rate of tax paid on its non-US earnings that were subject to the one-time transition tax under Section 965.[76] These corporations are also subject to more onerous rules under the BEAT regime, and dividends paid by such corporations are not eligible for the reduced rate of taxation otherwise applicable to qualified dividend income.[77] A special excise tax may also apply to certain stock compensation of insiders or large shareholders of a US corporation that inverts to a non-US jurisdiction.[78]

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

The IRS can rely on various rules, whether statutory or developed through case law, to combat tax avoidance, including the step transaction doctrine, the business purpose requirement (imposed on reorganisations and spin-offs) and the economic substance doctrine. The United States has also enacted complex anti-deferral regimes, discussed below, that are generally aimed at subjecting income received in low-tax jurisdictions to current US federal income taxation. The United States also seeks to prevent treaty shopping by negotiating for a strict limitation on benefits article in its treaties.

ii Outward investments in non-US corporations

The United States has enacted several anti-deferral regimes generally aimed at preventing the deferral of income earned offshore through non-US corporations. While these anti-deferral regimes may not be relevant to the non-US person establishing new US operations, they may be front and centre for the non-US multinational acquiring an existing US corporation with non-US operations.

One such anti-deferral regime is aimed at preventing the deferral of subpart F income in a CFC. For this purpose, subpart F income of a CFC includes:[79]

a passive income, such as dividends, interest, rent, royalties and gains from certain property transactions (referred to as foreign personal holding company income);[80]

employees, assets and income to be located or derived from the relevant non-US jurisdiction; the non-US acquiring corporation must also be a tax resident of the relevant non-US jurisdiction, unless the relevant non-US jurisdiction does not impose corporate income tax.

76 Section 965(l).

77 Section 59A(d)(4); Section 1(h)(11)(C)(iii)(II).

78 Section 4985.

79 Section 952.

80 Sections 952(a)(2) and 954(c).

b income earned in a jurisdiction resulting from related-party transactions where there may be little activity and value added in the non-US jurisdiction where the CFC is created or organised (referred to as foreign base company sales income and foreign base company services income);[81]

c certain insurance income;[82]

d income from operations that participate in or cooperate with an international boycott;[83] and

e certain other types of income.[84]

With respect to foreign personal holding company income, a key exception is the same country exception, which generally provides that certain payments of dividends, interest and royalties received by a CFC from a related person do not give rise to an income inclusion (subject to current taxation) in the United States if such related person is created or organised under the laws of the same jurisdiction as the CFC and (1) in the case of dividends and interest, uses a substantial part of its business assets in that jurisdiction or (2) in the case of royalties, uses the royalty-generating property within that jurisdiction.[85] Other exemptions are also available, and the rules of subpart F should be consulted.

A non-US corporation is generally considered to be a CFC if more than 50 per cent of the vote or value of the non-US corporation is owned by United States shareholders,[86] which are defined as US persons owning at least 10 per cent of the total vote or value of all classes of stock of the non-US corporation.[87] In determining whether the ownership thresholds are met, the Code contains various attribution rules that take into account the stock that is indirectly or constructively owned.[88]

Another anti-deferral regime applies, without regard to the level of US ownership, to a non-US corporation classified as a passive foreign investment company (PFIC). A non-US corporation is classified as a PFIC with respect to any US shareholder if at least 75 per cent of its gross income is passive income or if at least 50 per cent of its assets are passive assets.[89] However, a CFC will not be treated as a PFIC with respect to a United States shareholder so that a United States shareholder of a CFC will be subject to the CFC regime but not the PFIC regime.[90]

iii GILTI

The GILTI regime is another anti-deferral regime, pursuant to which a United States shareholder of a CFC is currently required to include in taxable income its share of its CFC's GILTI. A United States shareholder's GILTI inclusion is generally based on its share of net CFC tested income (i.e., its aggregate pro rata share of tested income over tested losses) for the taxable year over an assumed 10 per cent return on its share of the CFCs' basis in tangible

81 Sections 952(a)(2) and 954(d)-(e).
82 Sections 952(a)(1) and 953.
83 Section 952(a)(3).
84 Section 952(a)(4)-(5).
85 Section 954(c)(3).
86 Section 957.
87 Section 951(b).
88 Section 958.
89 Section 1297.
90 Section 1297(d)

depreciable property. CFC tested income or loss is generally equal to the United States shareholder's pro rata share of each CFC's gross income, excluding ECI, subpart F income, high-taxed income excluded from subpart F income, non-US oil and gas extraction income, and certain related-party dividends, less the United States shareholder's pro rata share of any allocable deductions and non-US taxes.[91] A US shareholder of one or more CFCs may elect on behalf of its CFC group to exclude high-taxed income (generally, income subject to non-US tax at a rate greater than 90 per cent of the then-effective maximum US corporate tax rate) from GILTI.[92] A US corporation is allowed to claim a credit for non-US income taxes paid with respect to GILTI, but these credits are limited to 80 per cent of non-US income taxes paid and cannot be carried forward or back, or used to offset any other income.[93] In addition, while both corporate and non-corporate US shareholders must include their GILTI in income, generally only US corporations are entitled to a 50 per cent deduction (37.5 per cent for taxable years beginning after 31 December 2025) on the included GILTI.[94]

iv Transfer pricing

The purpose of the US transfer pricing regime is to ensure that taxpayers clearly reflect income attributable to controlled transactions (i.e., transactions between parties that are under common control) and to prevent tax avoidance with respect to such transactions.[95] There is no precise definition of what constitutes common control. The general standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer,[96] and the Treasury Regulations require a taxpayer to use the most reliable method for determining an arm's-length result (the best method rule). Penalties of up to 40 per cent may apply on an underpayment of tax resulting from a taxpayer's deviation from the arm's-length standard;[97] however, taxpayers can avoid such penalties if the taxpayer reasonably used a method specified by Treasury Regulations to determine the transfer price, has documentation to support the determination of the price and provides the documentation within 30 days of a request from the IRS.

For sales of tangible property, the methods described in the Treasury Regulations include:

a the comparable uncontrolled price method;
b the resale price method;
c the cost-plus method;
d the comparable profits method;
e the profit-split method; and
f unspecified methods.[98]

For transfers of intangible property, a fundamental principle is that the income received must be commensurate with the income attributable to the intangible. The methods include:

a the comparable uncontrolled transaction method;

91 Section 951A.
92 Section 951A(c)(2)(A)(i)(III); Treas. Reg. § 1.951A-2(c).
93 Section 960(d).
94 Section 250.
95 Treas. Reg. 1.482-1(a).
96 Treas. Reg. 1.482-1(b).
97 Sections 6662(e) and (h).
98 Treas. Reg. § 1.482-3.

b the comparable profits method;
c the profit-split method; and
d unspecified methods.[99]

The Treasury Regulations also address the transfer pricing of controlled services transactions. The methods include:
a the services cost method;
b the comparable uncontrolled services price method;
c the gross services margin method;
d the cost of services plus method;
e the comparable profits method;
f the profit-split method; and
g unspecified methods.[100]

The Treasury Regulations also address cost-sharing arrangements with respect to the development of intangibles, whereby commonly controlled parties share the costs of developing one or more intangibles in proportion to each party's share of reasonably anticipated benefits from the cost shared intangibles.[101]

Many taxpayers find it advantageous to enter into an advance pricing agreement (APA), with the IRS, which generally precludes the IRS from challenging the relevant transfer pricing for the period specified in the agreement. The APA is discussed further in the next section.

v Tax clearance and rulings

The IRS generally does not issue tax clearance certificates, except in certain limited circumstances. As a result, it is common practice for the acquirer of a US entity to conduct a tax lien search. US state and local jurisdictions may issue tax clearance certificates; however, the availability of, procedures for requesting, and the types of taxes covered by the tax clearance certificate vary by jurisdiction.

A taxpayer may request a private letter ruling from the IRS when there is uncertainty regarding the US federal income tax treatment of a transaction or an item of income or deduction or credit. The procedures and fees for obtaining a private letter ruling are published annually by the IRS in the first revenue procedure of each calendar year.[102] The IRS also publishes annually a list of those areas on which the IRS normally will not issue a private letter ruling.[103]

A taxpayer may request that the IRS enter an APA with the taxpayer to ensure that the taxpayer's transfer pricing methodology is not challenged by the IRS. APAs may also be bilateral (or multilateral), which combines an agreement between the taxpayer and the IRS on an appropriate transfer pricing methodology with an agreement between the IRS and a non-US taxing authority (or, in the case of a multilateral APA, two or more non-US taxing authorities) that the methodology is acceptable to each taxing authority.[104] A taxpayer may

99 Treas. Reg. § 1.482-4.
100 Treas. Reg. § 1.482-9.
101 Treas. Reg. § 1.482-7.
102 *E.g.*, Rev. Proc. 2023-1, 2023-1 I.R.B. 1.
103 *E.g.*, Id.; Rev. Proc. 2023-3, 2023-1 I.R.B. 144; Rev. Proc. 2023-7, 2023-1 I.R.B. 305.
104 Rev. Proc. 2015-41, 2015-35 I.R.B. 263.

also be able to enter into a pre-filing agreement with the IRS, which ensures that the IRS will not challenge how a taxpayer reports certain positions on its return for a specified number of years.[105] Further, US tax treaties generally contain a provision that allows for a competent authority agreement, which grants the benefit of a treaty article the terms of which are not otherwise technically satisfied.[106]

X YEAR IN REVIEW

The IRA, which was signed into law in August 2022, enacted major federal policy changes impacting the US energy, environment and healthcare industries. Further, the IRA amended and enacted various tax credits to incentivise investment in green industries, including the solar, wind, carbon capture and electric vehicle industries, to increase the United States' production of clean energy and to reduce the effects of climate change. To help pay for these changes, the IRA enacted tax reform provisions. As discussed above, the IRA imposes a new 15 per cent AMT on a US corporation, with average AFSI in excess of US$1 billion effective for taxable years beginning after 31 December 2022. In the case of a multinational group with a non-US parent, this new AMT will only apply if, in addition to the US$1 billion threshold, the AFSI of the US members of the group and the effectively connected AFSI of non-US members of the group is at least US$100 million. The IRA also imposes a new 1 per cent excise tax on the repurchase of corporate stock by certain publicly traded corporations occurring after 31 December 2022. With respect to publicly traded non-US corporations, the excise tax can apply if a US subsidiary of the publicly traded non-US corporation repurchases its non-US parent's stock, and if a US subsidiary moves funds to a publicly traded non-US parent to facilitate the repurchase of stock by this publicly traded non-US parent or a non-US subsidiary of this parent. The IRS continues to issue guidance on the changes enacted by the IRA.

XI OUTLOOK AND CONCLUSIONS

As economies around the world continue to evolve, so do the tax laws in the United States. The United States experienced the most significant tax reform legislation in a generation with the enactment of the Tax Cuts and Jobs Act (TCJA) in 2017 under the Trump Administration. Notably, the TCJA lowered the corporate tax rate from a highest marginal rate of 35 per cent to a flat 21 per cent, repealed the corporate AMT, shifted the United States to a modified territorial system of international taxation, and changed many business tax provisions. Less than five years later, the Biden Administration has enacted the IRA, which brings back the corporate AMT in the form of a tax on book income, imposes a new 1 per cent excise tax on the repurchase of corporate stock by certain publicly traded corporations and establishes broad green energy tax credits. And it will not stop there – as of the time of writing, the Biden Administration has already suggested that the excise tax on stock repurchases should be increased from 1 per cent to 4 per cent. Moreover, in a few years, many key provisions of the TCJA will sunset, unless new legislation is enacted. Furthermore, the impending funding crisis for the Social Security and Medicare programmes likely requires new legislation to either increase taxes or reduce benefits. The outlook for major tax legislation in the next

105 Rev. Proc. 2016-30, 2016-21 I.R.B. 981.
106 Rev. Proc. 2015-40, 2015-35 I.R.B. 236.

two years, though, is dim. The House of Representatives is controlled by the Republican Party, while the Senate and the White House are controlled by the Democratic Party. Both political parties are preparing for another Presidential election in 2024, which may make compromise difficult.

As tax policies shift, the US Treasury Department and IRS focus on delivering guidance to the taxpayers. Guidance packages under the TCJA are largely complete at this point, and the Treasury Department and IRS are focused on delivering guidance to taxpayers on various issues related to IRA – many of which are time sensitive because the relevant provisions of the IRA are already effective. Despite all of the changes that have been made and those that may come in the future, one thing remains certain: effective tax planning will continue to play a crucial role in the success of any investment in the United States.

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Eric Homsi is a counsel in the New York office. Mr Homsi's practice concentrates primarily on advising public and private companies with respect to business tax issues associated with structuring, negotiating and executing domestic and cross-border acquisitions, divestitures and restructurings. Mr Homsi counsels clients on tax issues associated with real estate investments and joint ventures, equity and debt securities offerings, and other transactions where tax considerations play an important role. Mr Homsi also assists multinational businesses with inbound and outbound tax planning and strategy.

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