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You Can Change the World, But You Can't Change International Tax Law

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Our Team

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Sven is a passionate economist and BPM’s Transfer Pricing Practice Leader and Economic Consulting Practice Co-leader. He is an ambitious, proven leader with nearly 15 years of professional experience, both in-house and in public accounting. When serving his clients, Sven believes in a pragmatic, data-driven, yet hands-on approach, taking into consideration the business and operational needs of his clients and their stakeholders.

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Javier is a distinguished international tax lawyer and advisor. Javier’s unique perspective and expertise derives from over 17 years experience working with companies in major markets throughout the country and his background working with premier tax offices including a Big-4 National Tax Department and agencies of the Federal Government in Washington, D.C., including the U.S. Tax Court, the IRS Office of Associate Chief Counsel (International) and the U.S. Treasury Department. He works closely with, and acts as a trusted advisor to, company and organization management on tax matters affecting strategic decisions, providing a comprehensive perspective on global tax planning and compliance considerations serving organizations of any size and at any stage of their life cycle.

International Tax

Presenter Name: Javier Salinas

Activities Outside the U.S. / Choice of Entity

Activities Outside the U.S. / Choice of Entity

Specific / Isolated Event vs. Ongoing Presence

- Host a one-time conference
- Affiliation with a similarly-situated association (i.e., a local entity)
- Joint Venture
- Local office of a U.S. nonprofit
- Establish an "In-country Branch"
- Establish a nonprofit entity under local law

Activities Outside the U.S. / Choice of Entity

Questions to ask?

- What is your goal in the foreign jurisdiction?
- Long term/Short term?
    - Host of a one-time event
    - Establish a presence
- Partner or independent?
- Activities? Education; Sales; Events; Membership Dues; Distribution of Materials

Based on the answers to these questions, nonprofits should consider what type of organization or entity to establish abroad, if any.

Activities Outside the U.S. / Choice of Entity

What Geographic Location Makes the Most Sense for your Nonprofit?

- One-time event or establishing a presence?

  Always the threshold question.
- Are there onerous “registration” requirements to start “doing business”?
- Is it difficult, time-consuming or expensive to set up a tax-exempt entity?
- Does the United States maintain a Tax Treaty with that country?

Permanent Establishment and Residency Considerations

Introduction to Permanent Establishments (PE’s)

Determination of a PE

- A PE is a fixed place of business which generally gives rise to income or value-added tax liability in a particular jurisdiction

Practical Considerations

- Residence status of a company (place of effective business)
- Agency PE
- Home Office
- Services PE (in some treaties)
- Cross-border workers

Introduction to PE's

Residence Status of Entities

Tax Residency of Companies → **Place of Effective Management** → **Key Management and Strategic Decisions**

(e.g. board meetings, CEO and senior executives, senior day-to-day management, etc.)

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Introduction to PE’s

Residence Status of Entities

Agent

- Not independent
- Acts on behalf of the company
- Authority to conclude contracts
- Habitually

Home Office

- Degree of permanency
- Used on a continuous basis for carrying on business activities
- Company does not provide office
- Nature of the employment requires an office

Introduction to PE's

What is a Branch?

Attributes of a Branch

- For U.S. purposes, the term "foreign branch" means an integral business operation carried on by a U.S. person outside the United States
- Whether the activities of a U.S. person outside the United States constitute a foreign branch operation must be determined under all the facts and circumstances
- Evidence of the existence of a foreign branch includes, but is not limited to, the existence of a separate set of books and records, and the existence of an office or other fixed place of business used by employees or officers of the U.S. person in carrying out business activities outside the United States
- Activities outside the United States deemed to constitute a foreign branch if the activities constitute a permanent establishment under the terms of a treaty between the United States and the country in which the activities are carried out

Consequences of Determination of PE

- PE does not in itself mean that significant profits of the non-resident are taxable
  - Certain activities are exempt under treaties
  - Depends on analysis of functions, risks and assets of the PE
- MAP relief from double taxation may be available under tax treaties

Compliance Obligations

Foreign Information Reporting

Foreign Information Reporting Forms

Form 926, Transfers of Property to a Foreign Corporation

- This form is used to report transfers of cash or property to foreign corporations, and generally applicable if:
  - the organization holds at least 10% of the total voting power or total value of the foreign corporation immediately after the transfer (either directly or indirectly), or
  - the amount of cash transferred by the organization during the 12-month period ending on the date of the transfer is more than $100,000
- Exception for tax-exempt organizations that transfer stock or securities to foreign corporations
- Non-compliance penalty: 10% of FMV of property at the time of transfer

Foreign Information Reporting Forms

Form 5471, Information Return of U.S. Persons With Respect to Foreign Corporations

- Required to report an organization's ownership interest in a foreign corporation
- Virtually all nonprofits will qualify as either Category 3, 4, or 5
- Category 3 filers include organizations that owned 10 percent or more of the total value or voting power of the foreign corporation at any point during the tax year, or disposed of sufficient stock in the corporation to reduce their interest to less than 10 percent during the tax year
- Category 4 and 5 filers include organizations that controlled more than 50 percent ownership interest in the foreign corporation for an uninterrupted period of 30 days or more during any tax year, with Category 5 filers owning the stock on the last day of the tax year
- Non-compliance penalty: $10,000 penalty imposed for each annual accounting period of each foreign corporation

Foreign Information Reporting Forms

Form 8261, Passive Foreign Investment Company

What is a PFIC?

- A foreign corporation is a PFIC if:
- 75% or more of its gross income is from passive sources, or
- The average FMV of assets which produce or are held to produce passive income is 50% or more

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Foreign Information Reporting Forms

Form 8261, Passive Foreign Investment Company (cont.)

- A U.S. person that is a direct or indirect shareholder of a PFIC may need to file
  - Exempt organizations are not subject to any PFIC filing requirement if there is no UBTI involved
  - Even if there is UBTI there are special exceptions if the aggregate value of the PFIC stock owned by the charity is less than $25,000 and $5,000 for direct and indirect ownership, respectively
- Non-compliance penalty: could include a $10,000 (under Form 8938)

Foreign Information Reporting Forms

Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships

- Required to report an organization's transfers of cash or property to, or ownership interest in, a foreign partnership

- There are four categories of filers, the most common of which are Category 1, 3, and 4

  - Category 1 filers include organizations that control more than 50 percent ownership interest in the foreign partnership at any time during any tax year

  - Category 3 filers include organizations that directly or indirectly owned at least a 10 percent interest in the foreign partnership immediately after the contribution, or the value of property contributed by the organization during the 12-month period ending on the date of transfer is more than $100,000

Foreign Information Reporting Forms

Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships (cont.)

- Category 4 filers include organizations that acquired or disposed of sufficient interest in the foreign partnership to either move their ownership interest above or below 10 percent, or that changed their ownership interest by 10 percentage points — for example, from 15 percent to 25 percent

- Non-compliance penalty: $10,000 penalty imposed for each tax year the form was not filed

Foreign Information Reporting Forms

Form 5713, International Boycott Report

- Related to oversight efforts to counteract the participation of U.S. persons and companies in other countries' economic boycotts or embargoes

- Required to report (1) operations in or related to boycotting countries, and (2) the receipt of boycott requests and boycott agreements made

- Filing requirement also applies to U.S. organizations that are 10% or greater shareholders (by vote or value) in foreign corporations that have such operations

- Current list of boycotting countries: Iraq, Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates, and Yemen

- Non-compliance penalty: willful failure to file can result in a $25,000 fine, imprisonment for no more than one year, or both

Foreign Information Reporting Forms

Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons (and Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding)

- Required for reporting of U.S. source payments made to foreign persons
- Includes U.S. source payments of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical (FDAP) gains, profits, and income
- U.S. Withholding Agent has reporting requirement and withholding tax payment obligation
  - Is any U.S. or foreign person that controls, holds, disposes, or makes payment of any item of a foreign person that is subject to withholding
- Tax-exempt organization may be considered U.S. Withholding Agent
- Non-compliance penalty: up to 25% of unpaid tax for failure to file, failure to pay

Foreign Information Reporting Forms

Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)

- Required to report interests in foreign disregarded entities and foreign branches

- Beginning with the 2018 tax year, taxpayers are required to file Form 8858 to report activity of all foreign branches

  - Prior to 2018, this was only required for foreign disregarded entities

- Also, transactions between a U.S. person and a foreign branch, or transactions between foreign branches, are required to be made in accordance with the arm’s length transfer pricing standards

- This area wasn’t of great issue prior to the enactment of TCJA, but new foreign tax credit reporting rules have increased its significance

Foreign Information Reporting Forms

FinCEN 114 — Report of Foreign Bank and Financial Accounts (FBAR)

- Required to report a financial interest in or signature authority over a foreign financial account if the aggregate value of all such accounts exceeds $10,000 at any time during the calendar year.

- A foreign financial account is any financial account that is located outside of the United States, including but not limited to:

  - securities, brokerage, deposit, or other accounts maintained with financial institutions,
  - commodity futures or options accounts,
  - insurance and annuity policies with cash value, and
  - shares in a mutual fund or similar pooled fund that is available to the general public with a regular net asset value determination and regular redemptions

Value Added Tax (VAT)

What is VAT?

- VAT stands for Value Added Tax and is a tax on the supply of goods and services
- Goods and services must generally be supplied in the country charging VAT (but there are detailed rules for some businesses)
- It is charged at varying rates depending upon what is being supplied

Who is liable?

- A “taxable person” (which can be an individual, a partnership, a charity or a company) is liable for VAT on the supply of good and services made in the course of business

- Liability is generally limited to the local supply of goods and services in the country with a VAT regime

- VAT registered businesses can recover the VAT they incur on their purchases (input VAT), but they must charge VAT on their sales (output VAT)

When must you register for VAT?

- Local tax authorities are generally responsible for collecting VAT and an organization must register with them if its turnover is over the registration threshold

- Thresholds vary by country

- Obligation to register based on value of taxable sales over the last 12 months.

  - Monthly monitoring advisable to avoid missing registration deadline and incurring penalties

- Registration required if organization expected to exceed VAT registration threshold in the next 30 days alone

Transfer Pricing

Private Inurement and Private Benefit

- Organizations seeking tax-exemption under U.S. Internal Revenue Code must be organized and operated so that *no part* of their net earnings inure (i.e., accrue) to the benefit of any private shareholder or individual.
- Whether there is private inurement depends on the *economic reasonableness* of transactions between the organization and insiders. Insiders cannot receive a distribution of funds from the organization except as reasonable payment for goods and services.
- Among others, organizations have lost their exempt status including *other than arm's-length* purchases, sales, or property rental between the organization and insiders.
- Private inurement has been expanded to include private benefit, which is much broader in scope than private inurement.
  - The difference between these concepts is that private benefit encompasses not only benefits provided to insiders (i.e., private inurement) but also those granted to unrelated or disinterested individuals or for-profit entities.

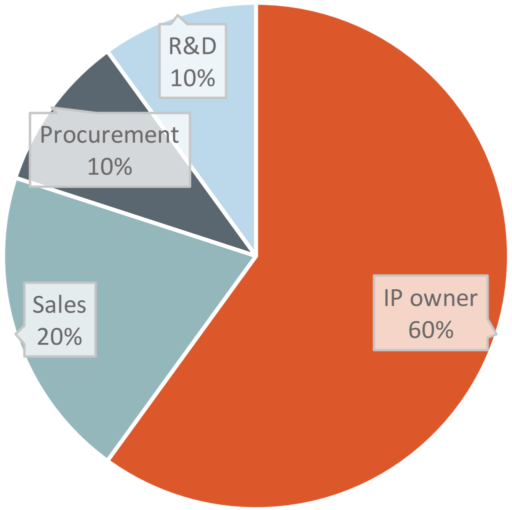
Taxpayers' and Tax Authorities' View

- The arm's length standard, in general, the worldwide standard in pricing and evaluating the reasonableness of related party transactions, constrains opportunism.
- Fiscal authorities want their "fair share" of the total (or global) profit pie generated by a(n) (multinational) organization:
    - Tax rate arbitrage drives multinational enterprises to/from different jurisdictions
    - The minimum outcome for a country is to protect the current tax revenue base
    - The better outcome for a country is try to grow the revenues collected from multinational taxpayers
- Getting a transfer pricing policy "wrong" can be expensive: Incremental taxation may be the result, and penalties and interest may be imposed by a local taxing jurisdiction.
- Transfer pricing is/can be highly subjective and requires in-depth knowledge of a company's industry, the key value drivers and supply/value chain of a business, its global strategy and sound economic analysis.

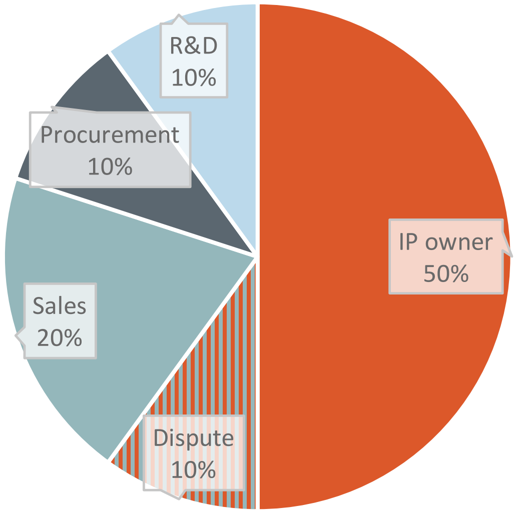
The Importance of Transfer Pricing

Transfer pricing focuses on the appropriate income allocation among related entities taking into consideration the activities / functions performed, assets employed (e.g., IP) and risks borne by each related party

Sample allocation of worldwide income across supply chain / jurisdictions



Sample allocation of worldwide income across supply chain / jurisdictions when cross-border transfer pricing disputes arise and income is subject to double taxation



Tax controversy arises if a jurisdiction disagrees with the allocation of income and imposes an income adjustment.

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Example

- European subsidiary, which markets and sells services to European customers, overpays its non-for-profit U.S. parent for the right to “sell” the services in its territory.
- On a consolidated basis, the operating income for the multinational enterprise is the same, but the allocation of taxable income is different.
- Intercompany pricing policy (i.e., transfer pricing) creates more income at the U.S. non-for-profit and less taxable income in Europe.
- The combined corporate tax rate in Germany where the subsidiary is located is 30% as compared to no federal tax due in the U.S. due to its non-for-profit status.
- The result is higher after-tax profits for the combined organization, but less tax revenue for Germany.

Example

	Non-for-profit Parent (United States)	Distributor & Marketer (Germany)	Total (Consolidated)
Sales	Transfer price	100,000	100,000
Cost of goods sold	< 50,000 >	< Transfer price >	< 50,000 >
Gross profit	(____%) __________	(____%) __________	50,000
Operating expenses	< 10,000 >	< 10,000 >	< 20,000 >
Operating income (≈ taxable income)	(____%) __________	(____%) __________	30,000

The issue at hand is what is the appropriate share of the total income that would be taxable in Germany which is a function of the transfer pricing entries highlighted above.

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Taxpayers’ and Tax Authorities’ View

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BPM Transfer Pricing

Planning & Consulting	Compliance & Documentation	Controversy & Defense
Development and implementation of global and domestic transfer pricing strategies	U.S., global and country-specific transfer pricing documentation	Transfer pricing controversy and tax examination / audit support
Preparation for compliance with the OECD's BEPS initiatives and value chain / relative contribution analysis	Global coordinated documentation and country-by-country reporting ("CbCR")	Dispute risk mitigation and resolution through Advance Pricing Agreements ("APAs")
Transfer pricing planning for tax-efficient supply chain optimization	Transfer pricing risk assessment and review	Dispute resolution through competent authority support
Intangible property planning, migration and cost sharing arrangements	Income tax provision and other financial reporting support	Economic advise to law firms and other external consultants who advise their clients in transfer pricing disputes and related matters
Due diligence analysis and IPO preparation		
Acquisition integration to align potentially disparate transfer pricing systems		
Support for local country incentives and rulings		
Ad-hoc transfer pricing advice and "extended workbench" arrangements		

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Thank You!