

Sourcing U.S. and Foreign Income: Dividends, Service Income, Property Sales, Rents, and Income Tax Treaties

WEDNESDAY, JULY 8, 2020, 1:00-2:50 pm Eastern

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Sourcing U.S. and Foreign Income: Dividends, Service Income, Property Sales, Rents, and Income Tax Treaties

July 8, 2020

Andre Benayoun, J.D.

Partner - Tax & Business Services

Marcum

andre.benayoun@marcumllp.com

Patrick J. McCormick, J.D., LL.M.

Partner

Culhane Meadows Haughian & Walsh

pmccormick@cm.law

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Sourcing of Income

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Presented by:
Patrick McCormick, JD LLM
Andre Benayoun, JD

July 2020

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Today's Agenda

1. Introduction & Background
2. Purpose of Income Sourcing Rules and the Section 904 Limit
3. Income Sourcing
4. Allocation and Apportionment of Expenses
5. Tax Treaties



Introduction & Background



- **Patrick J. McCormick** is a partner with Culhane Meadows. He earned his J.D. from Vanderbilt University Law School, and his LL.M. from New York University School of Law.
- Patrick exclusively practices in the area of international taxation, regularly publishing articles and giving presentations on assorted areas of international tax law. Patrick works with accountants located throughout the United States and internationally on international tax questions encountered by their clients.

Introduction



- **Andre Benayoun** is a Principal at Marcum LLP who specializes in consulting regarding international taxation for inbound and outbound multinational corporations, S corporations, partnerships, and individuals and families.
- Additionally, Mr. Benayoun is a frequent speaker at conferences and seminars on a range of international tax topics.

- Under default U.S. rules, nonresident aliens/foreign business entities are subject to United States tax on:
 - (1) income effectively connected with a United States trade or business, and
 - (2) fixed or determinable annual or periodic income
- **Non-U.S. taxpayers are subject to U.S. tax primarily on income items sourced to the United States**
 - Detailed sourcing rules for income items exist; for example, interest/dividend income is sourced to the payor’s location
 - Rent/royalties sourced to the place of use of the asset
 - Personal services sourced to where services performed

Default United States Tax Rules - Nonresidents

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Nonresident Taxpayers – United States Tax

- Under default rules, income earned by individuals effectively connected to a United States trade or business is subject to tax
 - “Trade or business” undefined in the Code/regulations – but profit-oriented activities carried on in the United States which are regular, substantial, and continuous are properly classified as a trade or business for these purposes
 - Effectively connected income includes performance of U.S.-based personal services and sales of United States real property interests
 - Macro-level – relatively light requirements to be considered engaged in a U.S. trade or business
 - Effectively connected income taxed by the United States at graduated rates, with deductions/credits available

Nonresident Taxpayers – United States Tax

- “Permanent establishment” standard used for U.S. evaluation of nonresident business activities under tax treaties – but this is not the statutory standard!
 - Statutorily, the United States subjects nonresidents to tax on any income “effectively connected with the conduct of a United States trade or business”
 - Treaty benefits available to nonresidents by election if resident of a treaty party country
 - If not a treaty party resident, results dictated by statutory rules (without ability for treaty modification)

Background Considerations

- Why does existence of a permanent establishment/U.S. trade or business matter?
 - Where a trade or business/permanent establishment exists, nonresident is taxed *as if they had separately incorporated* (in terms of direct income inclusion)
 - Gains/business profits indirectly associated with the trade or business/permanent establishment – such as capital gains – are taxable
 - Where a nonresident not engaged in a United States trade or business, she is taxed only on income sourced to the United States (rather than being taxable on worldwide income sourced to her U.S. trade or business)
 - Tax scope can be drastically reduced – with capital gains generally excluded from tax (outside real estate) and treaty provisions often excluding income from covered items (like certain royalties)

Nonresident Taxpayers – FDAP Income

- Fixed or determinable annual or periodic income (“FDAP income”) also subject to tax by the United States (for income items sourced to the U.S.)
 - FDAP income functions as a catch-all for U.S.-sourced income items (aside from capital gains) not otherwise subject to U.S. tax
 - Includes interest (subject to expansive exceptions), dividends, rent, salaries, wages, premiums, annuities, compensation, remuneration, etc.
 - Interplay exists between ECI and FDAP income
 - US-sourced income is classified as effectively connected to a U.S. trade or business rather than FDAP if it satisfies an asset use test or a business activities test
- FDAP income generally subject to a flat 30% rate of tax (with tax collected through withholding by payors)
 - Deductions not permitted for FDAP income

Taxpayer Classification

- Which individuals are United States taxpayers?
 - Citizenship – persons born in the United States, naturalized in the United States, or (under specified circumstances) where parents were United States citizens at the time of their birth
 - Classified as a “resident” for United States income tax purposes if:
 - Lawfully admitted for permanent residence (green card holder); or
 - Meet substantial presence requirements
 - Substantial presence test: must be present in the United States for 31 days during the relevant tax year and the sum of days for the last three years (after use of applicable multipliers) exceeds 183
 - Individuals not classified as United States taxpayers termed “nonresident aliens”

Taxpayer Classification

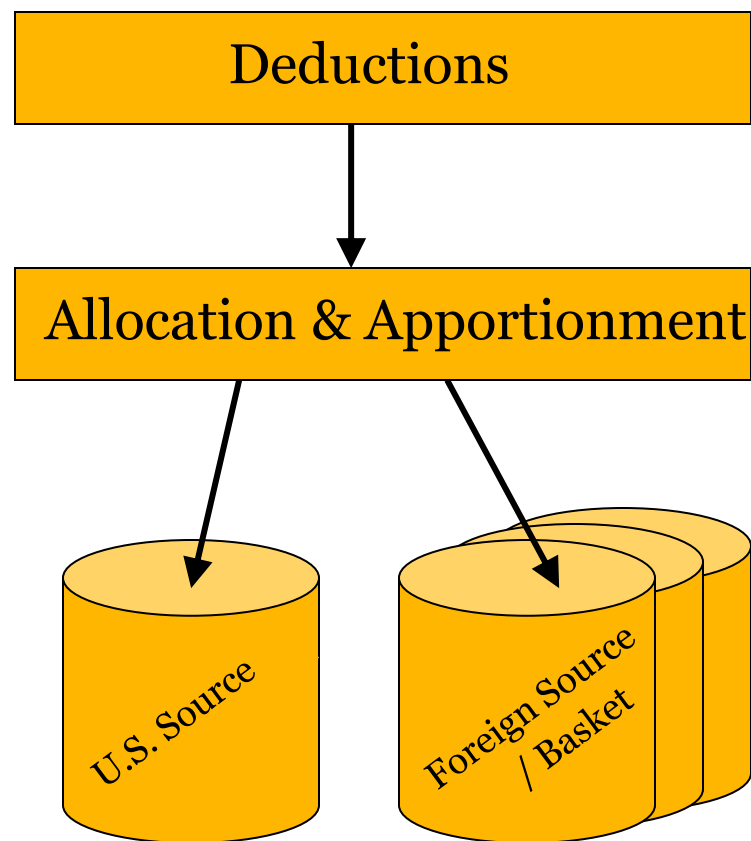
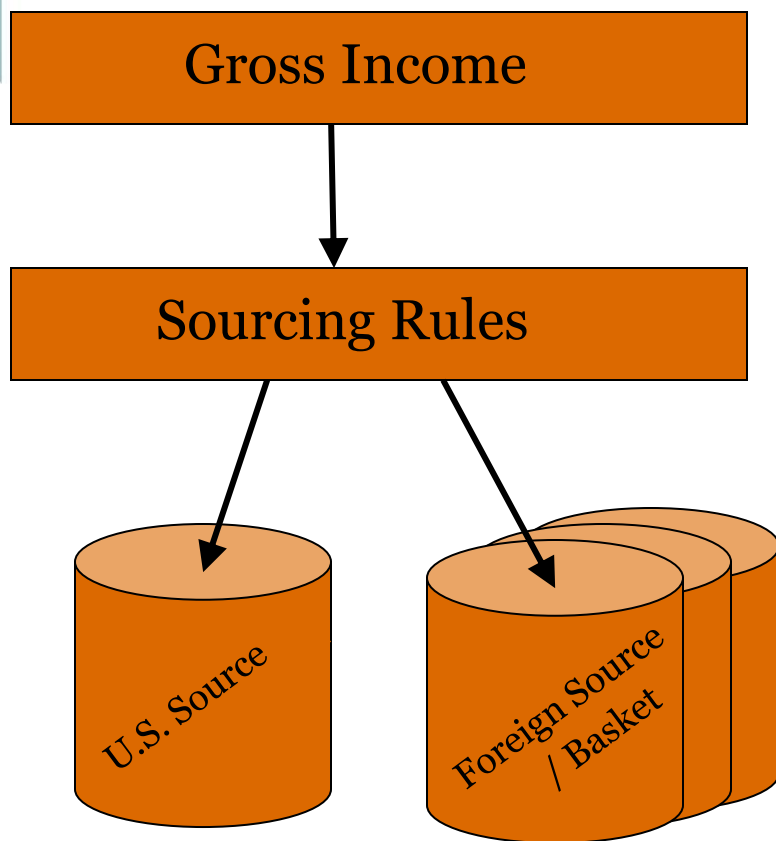
- Who is a U.S. taxpayer?
 - Exceptions exist to resident classification: (1) closer connection to another country and (2) treaty tiebreaker provisions
 - Closer connection exception: look to whether individual's facts and circumstances show a closer connection to another country
 - Available *only* for substantial presence residents!
 - Income tax treaties – individuals classified as residents of both treaty party countries are reclassified as a resident of only the one which contains their permanent abode or (if a permanent abode available in both) their “center of vital interests”
 - Available to *both* substantial presence residents and green card holders – but not citizens!
 - » Treaty reclassification **only** for income tax liability purposes – information reporting requirements largely unmodified

Taxpayer Classification

- United States citizens/domiciliaries taxable on transfers of worldwide assets, whether during life or at death
 - However, given a lifetime exclusion of \$11.58 million (for 2020fd)
 - Treated as a domiciliary for estate/gift tax purposes when maintaining a United States domicile – domiciliary is a United States resident *with no present intention of leaving*
 - Facts and circumstances determination – look to length of stay, ties to U.S. versus other countries, etc.
 - Imposes an elevated standard for presence-based tax as compared to income tax requirements!
 - Unlimited marital exclusion inapplicable for noncitizen spouses (even if domiciliaries/residents)
 - Bequests to noncitizen spouses typically done through QDOTs

Purpose of Income Sourcing Rules and the Section 904 Limit

Purpose of Sourcing Rules



Sourcing Implications - U.S. Persons

Determination of FTC limitation - §904

$$\text{FTC Limitation} = \frac{\text{Foreign Source Taxable Income (within Basket)}}{\text{Total Taxable Income}} \times \text{U.S. Income Tax Before FTC}$$

- Foreign Source Income Baskets include General, Passive, Branch, GILTI, and Treaty Resourced Income.

Limited FTC

	US 1120	---US Source---	--Foreign Source-- General Limitation
Taxable Income	\$100,000	50,000	50,000
U.S. Tax Liability Before FTCs	\$35,000		
Potential Foreign Tax Credits:			
Sec. 901/903 Direct Credits			5,000
Sec. 902 Deemed Paid FTCs			15,000
Total Potential FTCs			20,000
FTC Limitation:			
Foreign Source Taxable Income			50,000
/ Total Taxable Income			100,000
x U.S. Income Tax before FTCs			35,000
= FTC Limit (by basket)			17,500
Allowed FTC (Lesser of Actual vs Limit)	(17,500)		17,500
Residual (net) U.S. Income Tax Liability	\$17,500		
FTC Carryforwards	2,500		2,500

Income Resourced - Not Limited

	US 1120	---US Source---	--Foreign Source-- General Limitation
Taxable Income	\$100,000	40,000	60,000
U.S. Tax Liability Before FTCs	\$35,000		
Potential Foreign Tax Credits:			
Sec. 901/903 Direct Credits			5,000
Sec. 902 Deemed Paid FTCs			15,000
Total Potential FTCs			20,000
FTC Limitation:			
Foreign Source Taxable Income			60,000
/ Total Taxable Income			100,000
x U.S. Income Tax before FTCs			35,000
= FTC Limit (by basket)			21,000
Allowed FTC (Lesser of Actual vs Limit)	(20,000)		20,000
Residual (net) U.S. Income Tax Liability	\$15,000		
FTC Carryforwards	-		-

Sourcing Implications - U.S. Persons (cont'd)

- **Section 199 Domestic Production Activities Deduction (“DPAD”)**
 - The principles of the §861 regulations **were** applicable in determining the allowable deduction for domestic production activities under §199
 - The DPAD was repealed for tax years beginning after 2017

Sourcing Implications - U.S. Persons (cont'd)

- Exclusion of foreign earned income for U.S. individuals - §911

Form 2555	Foreign Earned Income	OMB No. 1545-0047
Department of the Treasury Internal Revenue Service (99)	▶ See separate instructions. ▶ Attach to Form 1040.	200 Attachment Sequence N
For Use by U.S. Citizens and Resident Aliens Only		
Name shown on Form 1040		Your social security number
Part I General Information		
1 Your foreign address (including country)		2 Your occupation
3 Employer's name ▶		
4 Employer's U.S. address ▶		

Sourcing Implications - Foreign Persons

- U.S. Source fixed, determinable, annual, or periodical (FDAP) income - potential withholding tax

Form W-8BEN (Rev. December 2000) Department of the Treasury Internal Revenue Service	Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding ▶ Section references are to the Internal Revenue Code. ▶ See separate instructions. ▶ Give this form to the withholding agent or payer. Do not send to the IRS.	OMB No. 1545-1621
Do not use this form for: <ul style="list-style-type: none">• A U.S. citizen or other U.S. person, including a resident alien individual• A person claiming an exemption from U.S. withholding on income effectively connected with the conduct of a trade or business in the United States		Instead, use Form: W-9 W-8ECI

Sourcing Implications - Foreign Persons (cont'd)

- Income effectively connected with a U.S. trade or business (ECI) - subject to U.S. income tax

1120-F Form Department of the Treasury Internal Revenue Service		U.S. Income Tax Return of a Foreign Corporation For calendar year 2002, or tax year beginning, 2002, and ending, 20, ▶ Instructions are separate.		OMB No. 154 200
Use IRS label. Other- wise, print or type.	Name		Employer identification number	
	Number, street, and room or suite no. (see page 8 of instructions)		⋮	
	City or town, state and ZIP code, or country (see page 8 of instructions)		Check applicable boxes: <input type="checkbox"/> Initial return <input type="checkbox"/> Name char <input type="checkbox"/> Final return <input type="checkbox"/> Address cl <input type="checkbox"/> Amended return	
A Country of incorporation			H Did the corporation file a U.S. income tax return Yes	

Income Sourcing

U.S. Framework for Sourcing Gross Income

Predominant Situs

Residence of
Recipient

Split Source

Predominant Situs

- Income classified based on the location of the economic activity that produced the income
- Examples include interest, dividends, personal services income, rents, royalties, sale of real property, sale of certain personal property, certain transportation income, insurance underwriting income, and social security benefits

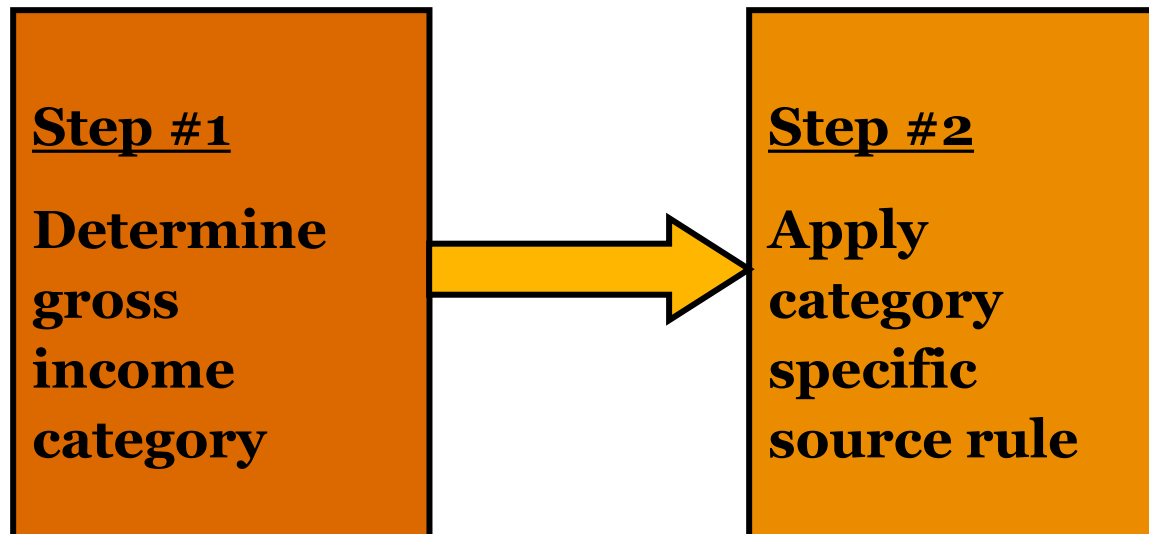
Residence of Recipient

- Income classified based on the residence of the recipient
- Examples include sale of personal property other than inventory, ocean or space income, and certain foreign currency gains and losses

Split Source

- Income classified as part U.S. source and part foreign source using a statutory or regulatory formula
- Examples include transportation and international communications income

Process for Sourcing Gross Income



Gross Income - Statutory Categories

Interest	§§861(a)(1) and 862(a)(1)
Dividends	§§861(a)(2) and 862(a)(2)
Personal services income	§§861(a)(3) and 862(a)(3)
Rentals and royalties	§§861(a)(4) and 862(a)(4)
Disposition of U.S. real property interests	§861(a)(5)
Sale of inventory	§§861(a)(6), 862(a)(6), and 863
Sale of personal property other than inventory	§865
Insurance underwriting income	§§861(a)(7) and 862(a)(7)
Social Security benefits	§861(a)(8)
Sale of certain partnership interest by foreign persons	§864(c)(8)

Roadmap To Source of Income Rules

- **§861 provides primary rules on sourcing gross income by indicating what constitutes US source income**
- **§862 indicates that foreign source income for the items listed in §861 are simply all items that are not US source**
- **§863 delineates the sourcing of**
 - Income derived partly within and partly from without the U.S. - §863(b) inventory sales
 - Transportation income
 - Space and certain ocean activities income
 - International communications income

Roadmap To Source of Income Rules (cont'd)

- **§864 contains definitions and special rules**
 - “Defines” trade or business within United States
 - Defines effectively connected Income (including new partnership sale rules)
 - Certain rules for allocating interest and other expenses
- **§865 contains detailed rules on the source of income from the sale of personal property**
 - General rule - Source of income determined by reference to the residence of the seller
 - Inventory - §§861(a)(b), 862(a)(b) and 863
 - Depreciable personal property (depreciation recapture)
 - Intangible assets (treated as a royalty if payments are contingent upon)
 - Stock of 80% owned affiliates
 - Sales through offices or fixed places of business

Interest Income

– General rule - Sourced according to the residence of the payer

- §§861(a)(1) and 862(a)(1)
- See §7701 to determine residence

– Major exceptions

- Interest from foreign branch of US bank
- US “80-20” company (repealed, but certain grandfathered benefits)
- Special rules for payments of interest by a U.S. branch of a foreign corporation under §884 or certain foreign partnerships under §861(a)(1)(C)

Dividend Income

- **General rule - dividends are sourced according to the residence of the payer**

- §§ 861(a)(2) and 862(a)(2)

- **Key Exceptions**

- 25% Look-through rule for foreign corporations with US trade or business (See § 861(a)(2)(B))
 - U.S. withholding tax on such U.S. source income is repealed effective for payments after 12/31/2004
 - But note that dividends “paid” by U.S. branch of a foreign corporation may be treated as U.S. source under the “branch” rules of Section 884

Personal Services Income

- **Personal services income is sourced based on where the services are performed - §861(a)(3) and §862(a)(3)**
 - Services performed both within and outside the U.S. generally must be allocated based on time spent - Treas. Reg. §1.861-4(b)(1)(i)
- **There is a *de minimis* rule for nonresident aliens who work temporarily in the United States (the so-called “commercial traveler” exception) - Treas. Reg. §1.861-4(a)(1)(i)**

Rent Income

- In general, rental income is sourced based on the place where the property is located or used - §861(a)(4) and §862(a)(4)
- The taxpayer must apportion the rental income on the basis of time, mileage, or some other appropriate base, if the property is used both inside and outside the US

Royalty Income

- Royalty income generally is sourced based on the place where the intangible property is used - §861(a)(4) and §862(a)(4)
- Intangibles include patents, copyrights secret processes, know-how, customer lists, goodwill, trademarks, trade brands (see also §197 and §936(h)(3)(B) for other types of intangibles)

Computer Software Income

- “Licensing” of computer software to a customer in exchange for a “royalty” might constitute a royalty, rental income from the lease of the diskette/program, or sales proceeds from the sale of the diskette/program
- Regulations provide guidance on classifying transactions that involve computer programs - Reg. §1.861-18

Computer Software Income - Classification

Event	Classification
Transfer of a copyright right where all substantial rights are transferred	Sale
Transfer of a copyright right where less than all substantial right are transferred	License
Transfer of a copyrighted article where the benefits and burdens of ownership pass to transferee	Sale
Transfer of a copyrighted article where the benefits and burdens of ownership do not pass to transferee	Lease

Real Property Income

- In general, gains from the sale or exchange of real property are sourced according to the location of the property - §861(a)(5)

Personal Property Other Than Inventory

- General rule - Gain from the sale or exchange of personal property other than inventory is sourced according to the residence of seller - §865(a)
 - Numerous exceptions exist within §865
 - One such exception is 865(e) – Special Rules for sales through offices or fixed places of business
 - Funds often try to avoid this issue with the umbrella fund not being engaged in a trade or business and only paying a management fee to another entity that may be deemed to be engaged in a trade or business
- US citizens or resident aliens are residents of the United States for this purpose unless they have a “tax home” in a foreign country, in which case gains will still be US source unless an income tax of at least 10% of the gain is actually paid to a foreign country - §865(g)(1) and (2)
- Partnership Interest – Gain from the sale of a partnership interest by a foreign person is now considered effectively connected income - §864(c)(8)

Inventory Income

- **Purchased inventory**
 - Gross income from the sale of inventory purchased for resale is sourced on the basis of where the sale occurs, i.e., “the title passage rule” - §861(a)(6) and §862(a)(6)
- **Manufactured inventory**
 - For tax years prior to 2018, manufactured inventory is sourced partially within the US and partially without the US
 - General rule is the 50-50 method - Reg. § 1.863-3
 - Source based on property factor and sales factor
 - Can elect to use the “Independent Factory Price”
 - For tax years 2018 and thereafter, manufactured inventory is sourced where production occurs - §863(b)

Inventory Income (cont'd)

- **50-50 §863(b) Method:**

- Foreign

$$\text{Property Factor} = \frac{\text{Average adjusted basis of foreign production assets}}{\text{Average adjusted basis of all production assets}}$$

- Sales

$$\text{Factor} = \frac{\text{Export sales where title passes abroad}}{\text{Total export sales}}$$

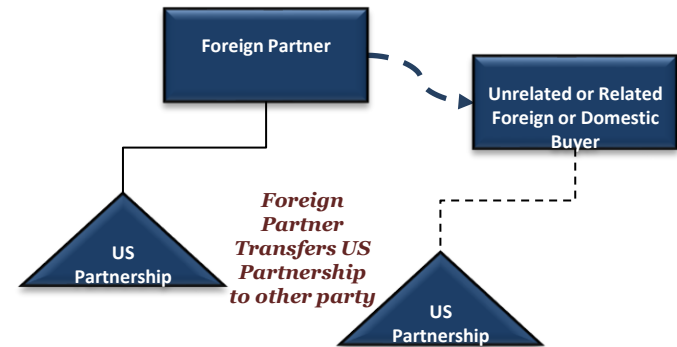
- **Reg. §1.863-3(c)**

Partnership Gain

Transfers of U.S. Partnership Interest

Transfers of U.S. Partnership Interest

- Generally, sale of capital gains assets by foreign persons are outside of the U.S. tax nexus. The IRS took the position that the sale of U.S. partnerships interest with effectively connected income (“ECI”) by foreigner partners were different (See Rev. Rul. 91-32). In 2017, their position was overruled in a court case (Grecian Magnesite Mining, Industrial & Shipping Co., SA v. Comm’r, 149 T.C. No. 3 (2017)).
- In response to Grecian Magnesite the Legislature passed new Sec. 1446(f) and 864(c)(8). The result of these new laws is to codify the IRS position from Rev. Rul. 91-32 such that the sale of U.S. partnership interests with ECI by foreign persons is subject to U.S. tax.

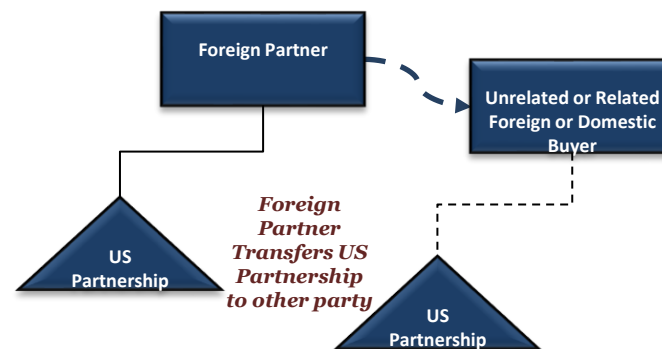


Partnership Gain (cont'd)

Transfers of U.S. Partnership Interest

Transfers of U.S. Partnership Interest (cont'd)

- The mechanism of tax follows the FIRPTA rules for foreigners investing in U.S. real property.
- Withholding is accomplished via Forms 8288 and 8288-A (the FIRPTA forms)
- Exceptions to the withholding tax:
 - Transferor is US (needs to provide a W-9 or qualifying statement that they are U.S. persons)
 - No gain on sale (transferor or partnership needs to provide a qualifying statement that there is no gain)
 - De minimis ECI from deemed sale of partnership assets (materiality is set at less than 25% or 10% of ECI depending upon whether the taxpayer chooses to follow Notice 2018-29 (25%) or Proposed Regs. for Sec. 1446 (10%). The statement showing de minimis ECI is required by the transferor or partnership)
 - 3-year ECI exception (if no material ECI in last 3 years, transferor may prepare a qualifying statement)
 - Non-Recognition transaction (a qualifying statement is required from the transferor)
 - Treaty benefits (certain treaties may allow for elimination of withholding. Must be supported via valid W-8BEN(-E) and submitted with a qualifying certification by transferor to the IRS within 30 days of the transfer.





Allocation & Apportionment of Expense

Allocate vs. Apportion Deductions

- Step 1 - Allocate to class of gross income
- Step 2 - Apportion between statutory and residual groupings
- Reg. § 1.861-8

Allocation

- Absent any special rules, allocate deductions to a class of gross income that represents a specific income-producing activity or property
- A deduction is allocated to a class if it is definitely related to a class of gross income
 - Deduction is definitely related if “incurred as a result of or incident to” the activity or property that gave rise to the gross income - Reg. §1.861-8(a) and (b)
 - A deduction may be definitely related to all of the taxpayer’s gross income - §1.861-8(b)(5)

Apportionment

- **After allocation among gross income, deductions within a class of income are then apportioned to statutory groupings and residual groupings based on any reasonable method - Reg. §1.861-8T(c)(1)**
 - Statutory grouping is gross income that, when reduced by deductions, becomes relevant under a particular operating provision (e.g., foreign source income within a basket when computing the foreign tax credit) - Treas. Reg. §1.861-8(a)(4)
 - Residual grouping is the remaining gross income not included in the statutory grouping
- **Expenses must be apportioned to US and foreign sources on a basis that “reflects to a reasonably close extent the factual relationship between the deduction and the grouping of gross income” - Reg. §1.861-8T(c)(1)**
- **The effect of an apportionment on the taxpayer’s tax liability and record-keeping burden is considered when determining whether an apportionment is sufficiently accurate - Reg. §1.861-8T(c)(1)**

Expenses Related to All Gross Income

- SG&A expenses may be apportioned based on any reasonable method
- Taxpayers have some flexibility here because the factual relationship between SG&A expenses and income is usually subjective

Expenses Not Definitely Related to Any Gross Income

- **Deductions not definitely related to any gross income are apportioned between statutory and residual groupings based on gross income - Reg. §1.861-8(c)(3)**
- **Examples include**
 - Real estate taxes on a personal residence
 - Medical expenses
 - Charitable deductions
 - Alimony
 - See Reg. §1.861-8(e)(9)

Required Methods for Apportionment

- Interest - §864(e) and Reg. §§1.861- 9 through -12 and 8T through -12T
- Research and experimental expenses - §864(f) and Reg. §1.861-17
- Losses from property - Reg. §1.861- 8(e)(7), and Reg. §1.865-1 and -2
 - Net operating losses - Reg. §1.861-8(e)(8)
 - State income taxes - Reg. §1.861-8(e)(6)
 - Stewardship expenses - Reg. §1.861-8(e)(4)
 - Legal and accounting expenses - Reg. §1.861-8(e)(5)

Interest Expense - Asset Method

- Taxpayers generally must apportion interest expense among all gross income in proportion to the assets used to generate that income, regardless of the specific purpose of the underlying debt - Reg. §1.861-9T(a)
 - See Reg. §1.861-10T for exceptions to this method
- The asset method recognizes that all of a taxpayer's assets and activities require funding and taxpayers have flexibility as to whether they fund these activities with debt or use cash on hand (thus requiring debt financing for other activities)
- Interest expense of members of an affiliated group is apportioned as if the members of the group were a single corporation - §864(e)(1) and Reg. §1.861-11T

Interest - Apportionment Formula

- Interest expense is apportioned among statutory groupings and residual groupings using the following formula:

- Interest Expense Apportionment Formula =

Assets that generate income apportioned to statutory/residual group

Total net assets

X

U.S. interest expense

- See §864(e)(2) and Reg. §1.861-9T(g)(1)

Asset Valuation - Tax Book Value

- **The value of an asset for interest expense apportionment purposes is its tax book value - Reg. §1.861-9T(g)(1)(ii)**
- **Tax book value is an asset's adjusted basis - Reg. §1.861-9T(g)(1)(iv)**
 - Tax book value is the average of the beginning-of-year and end-of-year values
 - Note that E&P of 10% owned foreign corporations must be added to the tax book value for purposes of this calculation – **§1.861-12T(c)(2)(iii)**

Asset Valuation - FMV Election

- The fair market value method was repealed as part of the TCJA effective for tax years after 2018

Tax Treaties

United States Income Tax Treaties – Basic Structure

- The United States maintains income tax treaties with roughly seventy countries, with each treaty containing distinct terms/articles built around common principles
 - Under treaties, residents of a treaty country can be taxed at a reduced rate, or even exempted from tax, on specified items of income from the other country
 - Savings clause prevents a United States citizen/resident/entity from using a tax treaty to alter tax on US-source income
 - Narrow exceptions are normally provided in treaties to the savings clause, allowing limited modifications to U.S. tax rules for specified foreign income items

United States Income Tax Treaties – Basic Structure

- Residency a critical aspect of treaty relief – foreign taxpayers are normally entitled to treaty benefits only when valid residents of a country with which the United States has a tax treaty
 - *Residency* required – citizenship without residency does not qualify an individual for treaty benefits
- Treaty definitions of residence normally include persons liable for tax to a country based on domicile, residence, citizenship, place of management, or place of incorporation
 - Corporations are residents of countries for these purposes if liable for tax based on the country being its place of management
 - Can have conflicts as to residence where place of management and place of incorporation differ
 - » Tiebreaker typically is the treaty between those two countries
 - Rules exist to prevent “treaty shopping” – entity creation solely for purposes of treaty benefits

Tax Treaties – Common Provisions

Benefits depend on specific treaty terms; however, some terms are commonly utilized in treaties

- Treaties usually provide that business profits of a resident of one country may be taxed by the other country only where a permanent establishment exists in that country and the profits are attributable to such a permanent establishment
 - » Can be compared/contrasted to U.S. trade or business requirements – higher threshold of activity/connection required
 - » Where no permanent establishment exists, nonresident only subject to U.S. tax on U.S. sourced income (rather than *all* income attributed to the permanent establishment, irrespective of source)

Tax Treaties – Common Provisions

Business profits subject to treaty tax – look to whether a permanent establishment exists, whether there is income, and whether the income is attributable to the permanent establishment

- Permanent establishment – fixed place of business through which the business of an enterprise is wholly or partly carried on
 - Includes place of management, branch, office, etc.
 - » Standard evolving with digitization of business – less need for physical presence to economically utilize a jurisdiction
 - Can also have attribution through which an agent conducts activities through a fixed place of business
- “Attributable to” – largely similar to the “effectively connected” concept

Tax Treaties – Common Provisions

Tax treatment of FDAP income also modified by treaty terms

- Treaties often reduce/eliminate tax on FDAP income
 - FDAP income attributable to a permanent establishment is governed by the business profits/permanent establishment treaty provision
 - Dividends – can still be taxed, but rates usually reduced
 - Tax of interest/royalties can be removed from source country under treaties

Foreign Derived Intangible Income

Foreign-Derived Intangible Income (“FDII”)

- **A deduction is allowed to *domestic corporations* in an amount equal to **37.5% of the FDII of the domestic corporation for the tax year****
- Deduction ONLY available to C-corporations!
- FDII equals deemed intangible income multiplied by a fraction: foreign-derived deduction eligible income over deduction eligible income.
 - FDII is the portion of intangible income derived from serving foreign markets; like GILTI, it assumes a 10% rate of return on tangible assets
 - FDII concept offers a special reduced effective tax rate on income from US-held intangibles; concept does not explicitly look at intangibles but assumes a fixed rate of return on business assets with the balance of income being from intangibles

André Benayoun — *andre.benayoun@marcumllp.com*
Patrick McCormick — *pmccormick@cmlaw.com*