USA

USA

General

1. What are recent tax developments in your country which are relevant for M&A deals?

Notice 2015-54

The Internal Revenue Service (IRS) issued Notice 2015-54 in August 2015 to address perceived abuses relating to the transfer of appreciated property (including IP) to a partnership with foreign partners. The notice outlines new regulations to be written by Treasury regarding the transfer by a U.S. person of appreciated property to a partnership that has a foreign partner related to the transferor. Under the new regulations which will be retroactively effective from August 6, 2015, income or gain attributable to the transferred property will be taken into account by the transferor either immediately or periodically using the remedial allocation method. Under the old rules, there was greater possibility for tax deferral.

Inversions

In recent years, Treasury has issued regulations under Sections 7874 and 367(a), as well as issued Notice 2014-52 and Notice 2015-79 to curtail inversions of U.S. companies. When a U.S. corporation becomes a subsidiary of a non-U.S. corporation or transfers its assets to a non-U.S. corporation, and the foreign corporation is owned 80% or more (by vote or value) afterwards by former owners of the U.S. corporation, the foreign corporation will be taxed as a U.S. corporation. Where less than 80% but at least 60% (by vote or value) of the foreign corporation is owned post-inversion by former owners of the pre-inversion U.S. entity, the U.S. corporation may not be able offset any gain from establishing the inverted structure with any tax attributes (e.g. net operating losses or foreign tax credits) for 10 years after the inversion. The ownership calculation is subject to a variety of modifications that can have the effect of increasing the ownership percentage of the U.S. shareholders for purposes of these rules. Proposed regulations will be issued this year to implement the 2014 and 2015 notices. The Obama Administration continues to study the feasibility of issuing regulations to limit the deduction for interest.

Section 336(e)

On May 15, 2013, Treasury published final regulations under Section 336(e), which permits taxpayers to elect to treat certain dispositions of a target corporation's stock as an asset sale for federal income tax purposes, thus delivering a step-up in basis of the target's assets to the buyer.

Prior to the issuance of the Section 336(e) regulations, taxpayers wishing to characterise stock acquisitions as asset acquisitions for federal income tax purposes (and deliver a step-up in the target's asset basis to the buyer) looked to Section 338(h)(10) or Section 338(g) (See Question 4 for discussion of Section 338 election).

In the context of a Section 338(h)(10) election, the focus is on the acquisition of stock by a corporate buyer, while in the context of a Section 336(e) election, the focus is solely on the seller's (or sellers') disposition of stock. As such, the Section 336(e) election may be made by the seller and the disposition can take the form of a sale, exchange, distribution or any combination thereof, provided that it is a taxable event (but not with a related party). In addition, provided that there is a "qualified stock disposition," then a Section 336(e) election may be made by the seller, regardless of the legal form of the buyer. As a result, individuals and partnerships, who are normally precluded from making Section 338(h)(10) elections, may engage in transactions where a Section 336(e) election is made.

Net Investment Income Tax

Effective January 1, 2013, the Net Investment Income Tax (NIIT) is imposed by Section 1411. The NIIT applies at a rate of 3.8% to certain net investment income of individuals, estates and trusts that have income above the statutory threshold amounts.

In general, investment income includes, but is not limited to: interest, dividends, capital gains, rental and royalty income, non-qualified annuities, income from businesses involved in trading of financial instruments or commodities and businesses that are passive activities to the taxpayer (within the meaning of Section 469).

Common examples of gains that are subject to the NIIT include gains from the sale of stocks, bonds, and mutual funds. In addition, gain from the sale of a partnership interest or S corporation stock generally is required to be included in net investment income, as the gain would not be considered derived in the ordinary course of a trade or business. However, there are special exceptions for non-passive owners of flow-through entities and for non-resident aliens.

Rev. Proc. 2015-13

In the course of negotiating a deal, potential unreserved tax liabilities may be identified by the buyer, such as positive (unfavorable) Section 481 adjustments related to accounting method changes. Historically, the change in method of accounting would be filed with the first post-acquisition tax return, with the result being that the buyer would suffer the effect of the unfavourable adjustment by recognising the additional income over the subsequent four year period.

However, a new elective mechanism has been introduced to resolve tax liabilities in the pre-closing period related to accounting method changes. Effective for changes to accounting methods after January 16, 2015, a buyer and seller may elect to recognise any additional taxable income that results from an acquisition-related accounting method change entirely in the final pre-acquisition tax year for the target.

This treatment effectively takes the additional taxable income that a buyer would have to recognise in the periods following an acquisition and places the tax burden back on the target in the pre-acquisition period. A buyer should ensure that target's final tax return for the pre-acquisition period includes the change in method of accounting, as well as the corresponding amount of additional taxable income.

2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive?

There have been no legislative changes made or proposed to implement the recommendations in the final BEPS reports.

The IRS has issued proposed regulations to implement Action 13 (Country-by-Country Reporting) which would be effective beginning in 2017. The IRS is considering how to coordinate the effective date of its regulation with most other countries that are implementing Country-by-Country Reporting beginning in 2016.

With respect to Action 6 the United States has issued proposed changes to the U.S. Model Income Tax Treaty that are expected to be finalised in the first half of 2016. The United States has limited interest in a multi-lateral instrument to amend its income tax treaties as nearly all U.S. income tax treaties now contain a limitation on benefits article.

3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

a. Share deal

In a stock acquisition, the target corporation remains intact, and any pre-closing historical or contingent liabilities remain with the acquired company. Moreover, where a corporation is acquired from a consolidated group, it remains liable for the entire group's federal income tax during the period in which it was a member.

Stock acquisitions may be taxable or non-taxable, depending on the structure chosen by the parties. Either way, the basis in the underlying assets of the target company carries over and is not stepped up — although where the target is a subsidiary within a consolidated group, complex rules may result in a step-down of the subsidiary's assets to avoid loss duplication. Where the target corporation is a corporation or a subsidiary in a consolidated group, however, it may be possible to make an election under Section 338 to treat the stock acquisition as if it were an asset purchase for tax purposes, resulting in a step-up in the basis of assets to fair market value.

In the case of a stock acquisition without a deemed asset purchase election under Section 338, any tax attributes, such as net operating losses or tax credits, continue with the acquired corporation (subject to the aforementioned loss duplication rules), but change in control limitations may be imposed on their use.

A stock acquisition often makes sense where an asset acquisition is not practical because it would subject the seller to two levels of income tax or because it would be too difficult to transfer the assets, contracts and licences into the name of the acquirer.

The sale of stock in a corporation generally does not result in transfer tax. However, where the corporation owns real estate, some states impose a "controlling interest" transfer tax on the underlying real estate of the acquired entity in the taxing state.

Additionally, certain disclosure and withholding rules may apply to stock transfers to non-U.S. resident buyers (entities or individuals).

It should also be noted that the gain on the sale of stock is generally capital and therefore subject to preferential rates if the seller is an individual. As described in Question 14, foreign persons are not generally taxed in the U.S. on gains from the sale of a corporation's stock, except where the corporation is a U.S. real property holding corporation.

b. Asset deal

A significant reason for structuring a transaction as an asset acquisition is that historical business liabilities (including income taxes) of the target business ordinarily do not carry over to the acquirer. These liabilities remain with the seller unless there is a contractual agreement specifically providing otherwise. A major exception, however, exists in the case of certain non-income taxes (sales and use, payroll, and property). Here, a buyer may succeed to the seller's historical obligations under local law.

Asset acquisitions may be taxable or non-taxable, depending on the structure chosen by the parties. In addition, it may be possible to treat the acquisition of certain entities as if an asset purchase occurred for income tax purposes even though it is the ownership interests that are legally acquired.

A major advantage of a taxable asset purchase is that, in the instance where the seller would recognise gain, the buyer receives a corresponding step-up in the basis of the assets acquired to fair market value, often resulting in increased future depreciation or amortisation deductions for the buyer. Existing tax attributes, such as net operating losses, however, do not carry over to the purchaser.

If the assets are acquired in a tax-free exchange, the acquirer generally takes over the target's historical basis in the assets. Other tax attributes are generally lost unless the acquisition is structured as a business combination that is classified as a tax-free "reorganisation". Here, the survivor succeeds to the target's historical attributes and liabilities, though the attributes may become restricted under various rules.

If material appreciation exists in the hands of the seller, asset purchases are usually most viable when the target assets are held in a pass-through entity such as a partnership or an S corporation (which is not subject to an entity-level income tax), or where the assets are held by a subsidiary of a consolidated group of corporations. In contrast, where the target assets are appreciated and held in a C corporation, an asset sale may not be practical because there are two levels of income tax: (1) corporate-level tax on the gain and (2) shareholder-level tax on any subsequent distribution to the shareholders. If, on the other hand, assets are depreciated, a C corporation with operating income may be motivated to sell assets in order to recognise loss and offset such operating income.

Asset sales may result in significant transfer taxes. Many states and local jurisdictions impose sales and use tax on asset transfers, though occasional or isolated sale exemptions often apply. Real property is generally subject to realty transfer or documentary stamp tax.

Asset purchases may also create issues for many non-tax reasons. For instance, an asset purchase may not be feasible where the target business has significant assets, licenses or contracts that would be administratively burdensome or expensive to transfer or renegotiate.

It should also be noted that asset sales may give rise to both ordinary and capital gain (taxed at a reduced rate for individuals). In the case of a disposition by a foreign person, gain is ordinarily treated as effectively connected income subject to U.S. tax.

Buy-side

4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

Where a corporate buyer purchases at least 80% of the stock (vote and value) of another corporation in one or a series of transactions within a 12-month period from an unrelated seller, it may be possible to make an election under Section 338 to treat the stock acquisition as an acquisition of assets for income tax purposes. Depending on the nature of the transaction, the election may be made unilaterally by the buyer or jointly by the buyer and seller. Situations where the target is an S corporation or a member of a consolidated group often provide the best opportunity for this type of planning.

As discussed above, a step-up may also be obtained under Section 336(e) where there is a “qualified stock disposition.” A qualified stock disposition is a taxable disposition by a domestic corporation or the shareholders of an S corporation of at least 80% (by vote and value) of the stock of a domestic corporation during a 12-month period. A seller can make a Section 336(e) election, regardless of the legal form of the buyer(s). The Section 336(e) election may be most appealing in circumstances in which the acquiring entity is an LLC or partnership.

In the context of a foreign target, a Section 338(g) election should be considered, which also causes the transaction to be treated as an asset purchase for U.S. tax purposes. This election enables the target to step-up its basis in its assets and purge its pre-closing earnings and profits, thereby making it easier to push down debt and repatriate profits efficiently.

If a partnership interest is acquired, it may be possible for a buyer to step up its proportionate share of the partnership’s underlying assets by making an election under Section 754. Otherwise, the partnership’s assets are not ordinarily stepped up.

5. What are the particular rules of depreciation of goodwill in your country?

Depreciation rules vary depending on the nature of the asset.

- Furniture, fixtures, machinery, equipment and computers are generally depreciated using an accelerated method over a five- to seven-year period.
- Buildings are generally depreciated using a straight-line basis over a 27.5-year period (residential real estate) or 39-year period (non-residential real estate). Improvements are depreciated in the same way as the underlying property, but leasehold improvements may qualify for 15-year depreciation.
- Land is generally not depreciable, though land improvements may be depreciable over 15 years.
- Intangible assets (including goodwill) acquired as part of a trade or business are amortised using the straight-line method over a 15-year period. Intangible assets not acquired as part of a trade or business are generally amortised using a straight-line basis over their estimated useful lives. Software not acquired as part of a trade or business may be amortised using the straight-line method over three years.

6. Are there any limitations to the deductibility of interest on borrowings?

In general, a deduction is allowed for interest paid or accrued within a tax year on valid indebtedness of the taxpayer. However, numerous exceptions and provisions may limit or bar the deduction. Some of the major limitations are highlighted here:

Debt or equity considerations: Purported indebtedness may be reclassified as equity if the instrument characteristics create a sufficient resemblance to such. Interest on debt that is reclassified may be recast as a non-deductible dividend. Whether an instrument is reclassified is highly subjective and fact intensive. Courts rely on a number of factors, and no one factor is determinative. Here are just a few of the many factors:

- The intent of the parties and the adherence to formalities,
- The identity of the creditors and shareholders,
- The ability of the corporation to obtain funds from outside sources, and
- The thinness of the capital structure and the risk involved.

Transfer pricing: The Internal Revenue Service has the ability under Section 482 to adjust the interest rate on loans between related parties to reflect an "arm's-length" standard.

Interest owed to related foreign persons: In general, interest owed to a related foreign person that is otherwise deductible may not be deducted until it is paid.

Earnings stripping: Section 163(j) limits the deductibility of interest paid by a U.S. corporation if the debt is borrowed from or guaranteed by a related foreign person and the interest is exempt from U.S. tax. Section 163(j) applies if the U.S. corporation's debt-to-equity ratio exceeds 1.5 to 1. In general, the rule prohibits a corporation from deducting the interest paid to a related foreign person (or paid on debt guaranteed by a related foreign person) to the extent its "net interest expense" exceeds 50% of the corporation's "adjusted taxable income" as those terms are defined by the IRC. Interest in excess of this 50% limit can be carried forward indefinitely.

AHYDO: If an instrument is classified as an applicable high-yield discount obligation (AHYDO), a portion of the interest deduction is deferred until paid and a portion may be permanently disallowed and treated as a non-deductible dividend. In general, debt issued by a corporation may constitute AHYDO if it:

- Has a maturity date of more than five years,
- Has a yield to maturity of five percentage points over the "applicable federal rate" (as published by the IRS), and
- Has "significant original issue discount" (an excess of original issue discount accruals over actual interest payments).

7 What are usual strategies to push-down the debt on acquisitions?

There are many ways to push down debt in acquisitions of U.S. corporations. One common strategy is to form a domestic holding company which, in turn, forms a temporary merger subsidiary used to effect the acquisition. Upon the consummation of the transaction, the merger subsidiary is merged into the target and the proceeds are disbursed to the selling shareholders in exchange for their stock. Financing is arranged for the merger subsidiary, which is subsequently assumed by the target as the successor to the merger. Financing may come directly from third parties or internally through back-to-back loans (subject to conduit financing rules).

If the acquisition is initially done without using debt at the local level, it can subsequently be introduced in the U.S. through a variety of means. Direct financing of the target and a distribution of the proceeds may be one way. Causing the target to be sold to a newly formed domestic subsidiary of the foreign parent for a note may be another. Caution should be exercised however, as such transactions may create a dividend, giving rise to withholding tax.

8. Are losses of the target company(ies) available after an acquisition is made?

Generally, a net operating loss may be carried back to the two years preceding the loss and then forward to the subsequent 20 years to offset the taxable income in those years. Where the stock of a corporation is acquired, any net operating losses remain intact and may be used by the acquiring corporation, subject to certain change in control limitations. The most common limitation is imposed by Section 382. Here, where a corporation undergoes an "ownership change", generally defined as a more than a 50 percentage point change in its ownership over a three-year period, U.S. tax rules impose an annual limitation, called a "Section 382 limitation", on the amount of taxable income that can be offset by any pre-change net operating loss carryovers and built-in losses.

This limitation equals the product of the value of the loss corporation's equity immediately before the ownership change and the applicable federal long-term tax-exempt rate. The limit may be adjusted in certain circumstances which commonly include stuffing transactions and corporate contractions. If the Section 382 limitation for a post-change year exceeds the taxable income that is offset by pre-change loss, the Section 382 limitation for the next post-change year is increased by the amount of such excess. Special rules also apply for corporations with built-in gain (or loss) and those in bankruptcy.

9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax, etc.)?

As indicated in Question 3 above, the sale of stock in a corporation generally does not result in transfer tax. However, where the corporation owns real estate, some states may impose a "controlling interest" transfer tax on the underlying real estate of the acquired entity in the taxing state.

10. Are there any restrictions on the deductibility of acquisition costs?

Generally, the ability to deduct or the requirement to capitalise costs associated with acquisitive transactions hinges principally on the point in time at which the costs are incurred. The tax treatment of expenditures incurred in business acquisitions and dispositions is based on a fact intensive determination of the nature and reason for such expenses.

The general rule under Treas. Reg. Section 1.263(a)-5 requires the taxpayer to capitalise all costs that facilitate a transaction. In general, amounts paid in the process of investigating or otherwise pursuing a transaction are deductible only if the amount relates to activities performed before the earlier of (a) the date on which the letter of intent, exclusivity agreement, or similar written communication is executed by representatives of the acquirer and the target, or (b) the date on which the material terms of the transaction are authorised or approved by the board of directors (in the case of a transaction that does not require authorisation or approval by the board of directors, the date on which the acquirer and target execute a binding written contract reflecting the terms of the transaction).

Those costs that are inherently facilitative of the transaction are required to be capitalised regardless of whether they are incurred before or after the transaction commitment dates. Costs that are typically classified as inherently facilitative may include costs associated with appraisals, fairness opinions, structuring the transaction, preparation and review of transaction documents, obtaining shareholder approval and property conveyance costs (i.e., transfer taxes and title registration costs).

In addition, taxpayers can elect to treat any success based fees (e.g., banker fees) in accordance with Rev. Proc. 2011-29, which provides a taxpayer with a safe harbour that generally allows for the deduction of 70% of the success based fee (though certain other limitations may apply) and capitalisation of 30% of the fee.

A certain portion of the costs incurred in an underlying transaction may relate to debt issuance costs. In general, the costs associated with a borrowing are required to be capitalised. Debt issuance costs are generally amortised over the term of the underlying debt. When a debt obligation is satisfied, retired, or exchanged the taxpayer may deduct the unamortised debt issuance costs.

Determining the deductibility of transaction costs is a very facts intensive analysis, especially when dealing with multinational target companies where the transaction costs must be allocated across the different entities and jurisdictions involved. When transaction costs are expected to be significant, we recommend undertaking a formal transaction cost analysis, as this area is consistently challenged by the IRS.

11. Can VAT (if applicable) be recovered on acquisition costs?

There is no VAT, or related tax, imposed on transaction costs incurred in the U.S..

12. Are there any particular issues to consider in the acquisition by foreign companies? *(for example non-resident taxation rules/substance rules and tax efficient exit routes)*

Choice of entity: Foreign investors may choose from several types of entities to invest in the U.S.. Partnerships or Limited Liability Companies (LLCs), are generally not subject to income tax but instead are treated as "flow-through" entities where their income is taxed to their owners. Alternatively, corporations are subject to tax on their income and their shareholders are subject to tax when the income is distributed to them. Flow-through entities provide the advantage of a single layer of tax (as opposed to the double layer of tax in the corporate regime) and provide a seller a more tax efficient means to convey a step in the basis of the underlying assets to a buyer. Importantly, flow-through entities subject their owners to U.S. income tax and filing requirements and, for this reason, many foreign investors prefer to invest in the U.S. through a blocker corporation.

Capitalisation: Investors may choose between a combination of equity or debt. Debt may be from an external source or related party. The choice of debt versus equity may influence a company's taxable income and its ability to repatriate earnings efficiently. A key differentiating feature is that interest is deductible (subject to certain limitations) whereas dividends are not. Furthermore, repayment of debt is not subject to withholding whereas redemption of equity may be treated as a dividend subject to withholding.

Treaty protection: The U.S. has an extensive network of treaty partners. The ability to choose a favourable jurisdiction from which to invest should be a significant consideration.

Inversions: The Inversion rules discussed in Question 1 above need to be considered when a U.S. corporation is acquired by a foreign company. These rules can impact the U.S. tax treatment of the foreign acquirer, as well as the recognition of gain or loss related to the transaction.

Real estate: Special rules apply when investing in real estate which are discussed in question 14 below.

Exit considerations: Capital gains recognised by foreign persons are not generally taxed in the U.S. However, capital gains realised on the sale of an interest in a partnership engaged in a U.S. trade or business are generally subject to tax in the U.S.

Other considerations: Where a foreign buyer with a U.S. subsidiary is acquiring a foreign target, consideration should be given to causing the target to be acquired by the foreign parent so as not to create an inefficient "sandwich" structure.

13. Can the group reorganise after the acquisition in a tax neutral environment through mergers or a tax group?

A group may reorganise after an acquisition, but care should be given to the "step-transaction" doctrine, which courts often apply to integrate a series of otherwise separate steps, resulting in unanticipated or unfavourable tax consequences. Recent U.S. law also codified the use of "economic substance" doctrine. In general, the doctrine denies tax benefits arising from transactions that do not result in a meaningful change to the taxpayer's economic position other than a purported reduction in Federal income tax. If a transaction is found to lack economic substance, a strict liability penalty between 20% - 40% of the underpayment of tax attributable to the disallowance of the claimed tax benefit applies.

It is challenging to achieve tax advantages from a post-acquisition restructuring because of the general business purpose and economic substance requirements under U.S. tax law. Therefore, a buyer should focus on the tax planning alternatives as early in the acquisition process as possible.

14. Is there any particular issue to consider in case of companies of which main assets are real estate?

In general, foreign persons are not taxed in the U.S. on gains from the sale of a corporation's stock. The Foreign Investment in Real Property Tax Act (FIRPTA) however authorises the U.S. to tax non-resident aliens and foreign corporations on dispositions of a U.S. Real Property Interest (USRPI), including dispositions of a U.S. Real Property Holding Corporation (or USRPHC), A withholding tax of 15% of the amount realised by the foreign transferor is generally required to be withheld by the seller of a USRPI to ensure that an appropriate amount of tax is paid upon the disposition (higher withholding rates can apply in certain circumstances). The buyer can choose to file a U.S. tax return and report and pay tax on the actual gain realised at standard U.S. tax rates. A withholding tax also applies to non-resident aliens and foreign corporations that are partners, trust beneficiaries, or estate beneficiaries on the distribution of an interest in a partnership, trust, or estate that is attributable to a USRPI.

In general, a domestic corporation is a U.S. real property holding corporation if the market value of its U.S. real property interests constitutes 50% or more of the sum of the fair market value of (1) its U.S. real property interests, (2) its real property interests located outside the U.S. and (3) any of its other trade or business assets.

Legislation enacted late in 2015 would extend a favourable exception to FIRPTA for certain investments in a domestically controlled Real Estate Investment Trust (REIT) to similar interests in a Regulated Investment Company (RIC or mutual fund).

Sell-side

15. How are capital gains taxed in your country? Is there any participation exemption regime available?

Capital gains recognised by individuals are taxed at a preferential rate (currently a 15- 20% federal rate for the sale of assets held for longer than a year vs. a maximum 39.6% federal rate for "ordinary" type income), while those recognised by corporations are taxed at the corporate rate (currently a maximum 35.0% federal rate). Capital gains are also subject to state income taxes with rates ranging from 0% to approximately 10%. Capital gains recognised by foreign persons are not generally taxed in the U.S., however capital gains recognised on the sale of an interest in a partnership that is engaged in a U.S. trade or business are generally subject to U.S. tax. As noted above in U.S. individuals, estates, and trusts may be subject to the 3.8% net investment income tax.

The U.S. does not have a participation exemption regime.

16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

Depending on the nature of the target business and the business objectives of the parties, it is possible for sellers to defer gain by reinvesting in the continuing enterprise. Caution should be exercised, however, to ensure these complex rules are satisfied.

17. Are there any local substance requirements for holding/finance companies?

The U.S. imposes federal income tax on a residence basis, so any holding or finance company established in the U.S. will be subject to corporate level tax in the U.S., regardless of their substance. Companies not incorporated in the U.S. are generally not subject to U.S. income tax unless they have a sufficient presence (amounting to permanent establishment or "U.S. trade or business") or receive certain passive type income subject to withholding.

Generally, choosing a holding company jurisdiction for the purpose of avoiding or reducing withholding tax can be challenging in the U.S. because of anti-conduit provisions under U.S. law and the constantly intensifying limitations on benefits clauses in the various U.S. treaties. Generally, substance in the holding company jurisdiction is required. That said, various treaties provide reduced treaty rates. For example, assuming a UK holding company has adequate substance, the dividend withholding rate could be eliminated entirely.

Careful consideration should be given to the impact of the choice of jurisdiction of the holding company on other applications of withholding tax, including on interest and royalties paid by the U.S. company to related parties.

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