

# *What CFOs Need to Know About U.S. Tax*

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## *Scope and Limitations*

- The information contained in this presentation is for general guidance on matters of interest only. As such, it should not be used as a substitute for consultation with professional tax advisers.
- This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding any U.S. federal, state or local tax penalties.

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## *Types of Taxes*

- Federal Tax (US Government)
  - Regular Tax
    - › Marginal tax rate, ranges from 15% to 39%
    - › Large corporation generally end up paying flat rate of 34% or 35%
  - Alternative Minimum Tax (AMT)
    - › Paid in addition to Regular Tax to guarantee minimum tax
    - › AMT Credit in years in which Regular Tax is higher than AMT (can be carried forward indefinitely)
    - › Exception for “small” corporations
- State and Local Tax (“SALT”, assessed by each of the 50 states)
  - Income Tax
  - Franchise Tax (e.g., Delaware).

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## *Determination of Taxable Income*

- Conceptual difference in determining *Taxable Income* for US tax and Israeli tax purposes.
  - Israel – *Taxable Income* same as financial statement net income (“book income”) unless specific adjustments are required under Israeli tax law.
  - US – *Taxable Income* determined in accordance with the Internal Revenue Code and Regulations.
- Reconciliation of US *Taxable Income* and book income through book-tax adjustments (can be temporary or permanent).

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# ***Determination of Taxable Income***

## ***Main Selection of Common Book Tax Differences***

- ***Depreciation and Amortization §167 , §168 & §197***
- ***Stock-Based Compensation***
- ***Related Person interest stripping §163(j); §267***
- ***§263A costs***
- Federal Income Taxes §275
- Meals & Entertainment §274(n)
- Fines & Penalties §162(f)
- Wages over \$1 million §162(m)
- Domestic manufacturing deduction
- Tax-Exempt Interest §103
- State Taxes §164(a)
- Charitable Contributions §170(b)(2)
- Subpart F Income

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# ***Determination of Taxable Income***

## ***Selection of Common “Balance Sheet” Book Tax Differences***

- Deferred Revenue
- Prepaid expenses
- Advance payments
- Unbilled Receivables
- Accrued Payroll
- Reserve account
  - Allowance for bad debt
  - Inventory Reserves
  - Restructuring Reserves

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## *Adjustments to Taxable Income*

- *Taxable Income* is reduced by the following
  - NOL (may have limitations, e.g., Section 382)
  - Special Deductions (Dividend Received Deduction)
- *Income Tax* is reduced by tax credits such as:
  - R&D Credit
  - Foreign Tax Credit
  - AMT Credit (prior year minimum tax)
  - Other General Business credits (e.g., energy efficiency, etc)

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## *Filing Deadline*

- Tax return is due by 2.5 months following the close of the tax year (March 15<sup>th</sup> for calendar year taxpayer).
- 6 month automatic extension available if Form 7004 is filed by the original due date of the return:
  - Form 7004 extends the filing deadline, not the payment deadline; balance of tax due by original filing date.
  - Late filing penalty for failure to file by due date (5% a month, max 25%).
  - Late payment penalty and interest on late payment of tax (even if return is extended).



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## *Estimated Taxes*

- Taxpayers must pay in estimates throughout the year (IRS wants the money up-front):
  - Estimates are due on the 15<sup>th</sup> day of the 4<sup>th</sup>, 6<sup>th</sup>, 9<sup>th</sup>, 12<sup>th</sup> month of the year
  - Apply to all corporations whose tax liability exceeds \$500
  - Safe harbors:
    - 100% of current year tax
    - 100% of prior year tax (assuming prior year was 12 months and there was tax liability in the prior year)
    - Safe harbor for *large corporations* only allowable for Q1 estimate.
    - Penalty for failure to pay estimated tax

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## *Other Considerations and Reporting Requirements*

- Consolidated returns
  - Election year
  - Section 382
  - Separate Return Limitation Year (*SRLY*)
- Controlled Group
  - Two types – Parent/Sub OR Brother/Sister
  - Allocation of tax benefits (e.g., tax brackets, AMT exemption, etc)
- Form 1120-F – U.S. Income Tax Return of a Foreign Corporation
  - Required when foreign corporation has Trade or Business in the U.S.
  - Protective returns
- Foreign Reports – Information returns with regards to U.S. corporations' foreign operations

# Foreign Reporting Requirements

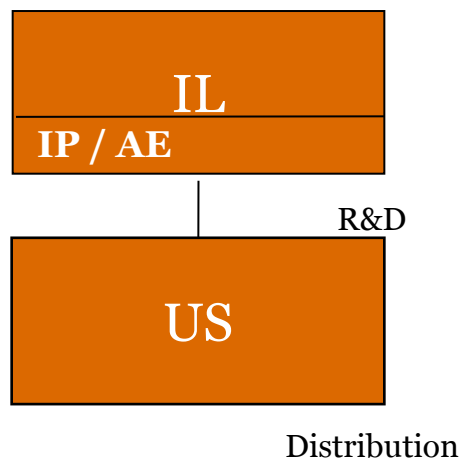
Form	Purpose	Due Date	Penalty
5471	The form is used by certain U.S. persons who are officers, directors, or shareholders in certain foreign corporations to report information required under sec. 6038 and 6046.	The due date of the tax return (including extensions)	Automatic \$10,000 per form/ per year for failure to file by due date (may also affect foreign tax credits).
5472	Form is used to provide information regarding reportable transactions of a reporting corporation with a foreign or domestic related party	The due date of the tax return (including extensions)	Automatic \$10,000 penalty if filed late.
926	To report certain transfers of tangible or intangible property to a foreign corporation required by section 6038B.	The due date of the tax return (including extensions)	10% of the fair market value of the property at the time of the exchange/transfer (limited to \$100k)
Form 1042	To report tax withheld on certain income of foreign persons, including foreign partnerships, and foreign corporations.	March 15	Later filing – 5% of unpaid tax per month up to max. of 25%  Later payment penalty – ½ of 1% of unpaid tax for each month or part of month the tax is unpaid
TDF 90.22-1	Report of Foreign Bank Account (includes bank accounts of more than 50% subsidiaries )	June 30	Civil and criminal Penalties . Penalty can reach \$500,000 or 20% of value of bank account, whichever is higher

# Foreign Reporting Requirements

## Common Structures of Tech Companies

### Structure 1

*IL Parent / US Sub*  
*IP owned by IL Parent*

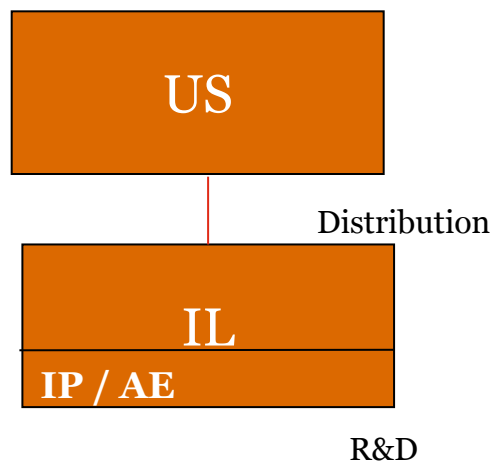


Form 1120

Form 5472

### Structure 2

*US Parent / IL Sub*  
*IP owned by IL Sub*



Form 1120

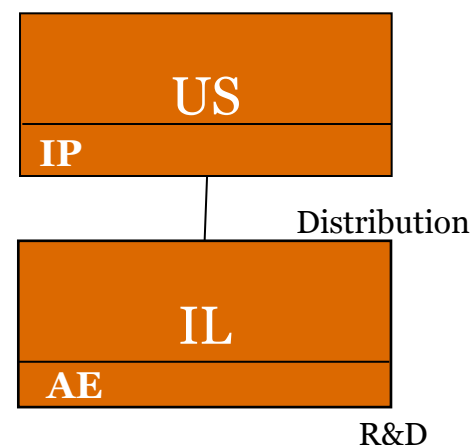
Form 5471

Form 926

TD-F - 90

### Structure 3

*US Parent / IL Sub*  
*IP owned by US Parent*



Form 1120

Form 5471

Form 926

TD-F - 90

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## *Foreign Reporting Requirements Points for Consideration*

When filing Form 5471/5472, attention should be given to:

- Presentation and disclosure of inter-company transactions.
- Calculation of Controlled Foreign Corporation (CFC) Earnings and Profits (E&P) (5471 only).
- Subpart F income (5471 only).
- Debt v. Equity classification; make sure desired classification is reported consistently as such, on Forms 1120 and 5471/5472.

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## *Debt vs. Equity*

### *In General*

- Cash advances are characterized as either debt or equity for US tax purposes.
- Taxpayer's characterization as debt/equity is binding on them, but the IRS can challenge the classification.
- Classification depends on several factors.
- Classification as debt or equity has significant tax implications throughout the life cycle of the instrument (grant, repayment period, conversion, exchange/disposal).

# ***Debt vs. Equity***

## ***Tax Implications Upon Repayment***

### ***Equity Characterization***

- Any payments made to the “Lenders” would be classified as:
  - (i) A dividend to the extent of a Company’s current or accumulated E&P;
  - (ii) Payments in excess of current and accumulated E&P would be treated as a return of capital;
  - (iii) Any payments in excess of the capital investment would result in a capital gain.

### ***Debt Characterization***

- Any payments made to the Lenders, to the extent of the accrued and unpaid interest would be treated as payment of interest.
- Generally, 30% withholding applicable to payments to non US residents.
- Exception: “Portfolio Interest”.
- Reduced withholding tax rates in case of a treaty.

# *Debt vs. Equity*

## *Main Classification Criteria*

- **The presence or absence of a fixed maturity date.**
- **The provision of a fixed rate of interest.**
- The intent of the parties, as indicated by the terms and the form of the agreement, **and the way the parties classified the instrument in their financial statements and tax returns.**
- Right to enforce the payment of principal and interest.
- The relative position of the obliges as to other creditors regarding the payment of interest and principal.
- **The “thinness” of the capital structure in relation to debt.**
- Certificate evidencing indebtedness.
- The source of payment, and the ability of the debtor to make repayments based on expected cash-flow on the date of issuance of the instrument.
- **The ability of the corporation to obtain funds from outside sources.**
- **Presence of conversion rights.**
- The identity between creditors and security holders.
- The extent of participation in management by the holder of the instrument.
- The voting power of the holder of the instrument.



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## *Schedule UTP*

- Final Schedule UTP released on September 24, 2010
- Corporate taxpayers that have total assets equal to or exceeding \$100 million must file Schedule UTP starting with the 2010 tax year
  - The total asset threshold will be reduced to \$50 million starting with 2012 tax years to \$10 million starting with 2014 tax years.
- Disclosure on Schedule UTP is required if two criteria are met
  - Corporation has taken a tax position on its U.S. federal income tax return for the current tax year or a prior tax year; and
  - Either the corporation or a related party has recorded a reserve with respect to that tax position for U.S. federal income tax in audited financial statements, or did not record a reserve for that tax position because the corporation or related party expects to “litigate” the position.

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## *Schedule UTP (Cont'd)*

- Corporations must rank each tax position disclosed on Schedule UTP by size (i.e., by the amount of U.S. federal income tax reserve recorded for that position).
- For each tax position listed on Schedule UTP, taxpayers must provide a concise description (an assessment of the hazards of a tax position or an analysis of the support for or against the tax position should not be included).

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# *Thank you!*

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