

U.S. Tax Updates and Development

28 November 2012

Doron Sadan, Tax Partner
Tzachi Schwartz, Senior Tax Manager

And the Winner is . . .



Agenda

- 1. Fiscal Cliff**
- 2. IRS Audit Activity**
- 3. Proposed Legislation**
- 4. Recent Cases**
- 5. Medical Device Excise Tax**
- 6. Inversion Transactions**
- 7. FATCA**

The Fiscal Cliff – Expired and Expiring Tax Provisions

- ***Fiscal Deficits***

1. The CBO projects the fiscal 2012 deficit to be about \$1.13 trillion, or 7.3 percent of GDP. This is lower than 2009 (10.1 percent of GDP), 2010 (9 percent of GDP) and 2011 (8.7 percent of GDP).
2. Before 2009 the last time the deficit surpassed 7 percent of GDP was in 1946.

- ***The Fiscal Cliff***

- **Tax Increase** - The expiration of tax cuts originally enacted in 2001 and 2003 (popularly referred to as the Bush tax cuts), and extended in December 2010, which will expire at the end of 2012.
- **Spending Cuts** – Across the board cuts in spending and expiration of various benefits.

The Fiscal Cliff – Expired and Expiring Tax Provisions

- ***Examples of Expired and Expiring Tax Provisions***
 1. Individual tax rates (25%, 28%, 33% and 35% compared with 28%, 31%, 36% and 39.6%).
 2. Lower individual tax rates for dividends (15% compared with ordinary income tax rates) and capital gains (15% compared with 20%).
 3. R&D Credits.
 4. The AMT “patch”.
 5. Bonus depreciation.
 6. Reduction in estate tax rates
 7. Long list of “extenders”

Rates Under Currently Enacted Law

Enacted Individual Federal Tax Rates for top income bracket

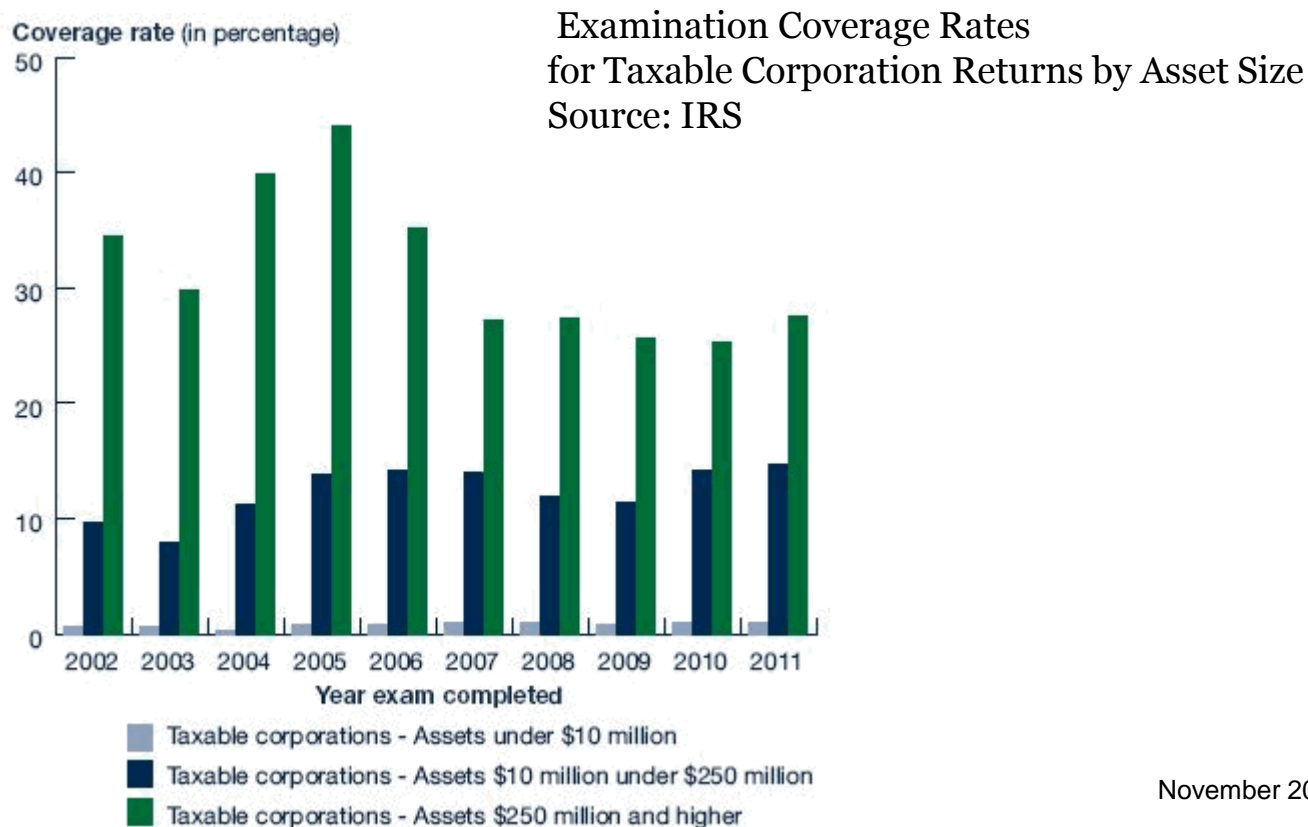
	2012	2013
Ordinary Service Income	37.9% ⁽¹⁾	43.4% ⁽²⁾
Ordinary Interest Income	35%	43.4% ⁽²⁾
Qualified Dividend Income	15%	43.4% ⁽²⁾
Short-term Capital Gains	35%	43.4% ⁽²⁾
Long Term Capital Gains	15%	23.8% ⁽²⁾

(1) Includes Medicare Tax of 2.9%.

(2) Includes Medicare Tax of 3.8%, does not account for phase out of certain itemized deductions scheduled beginning of 2013.

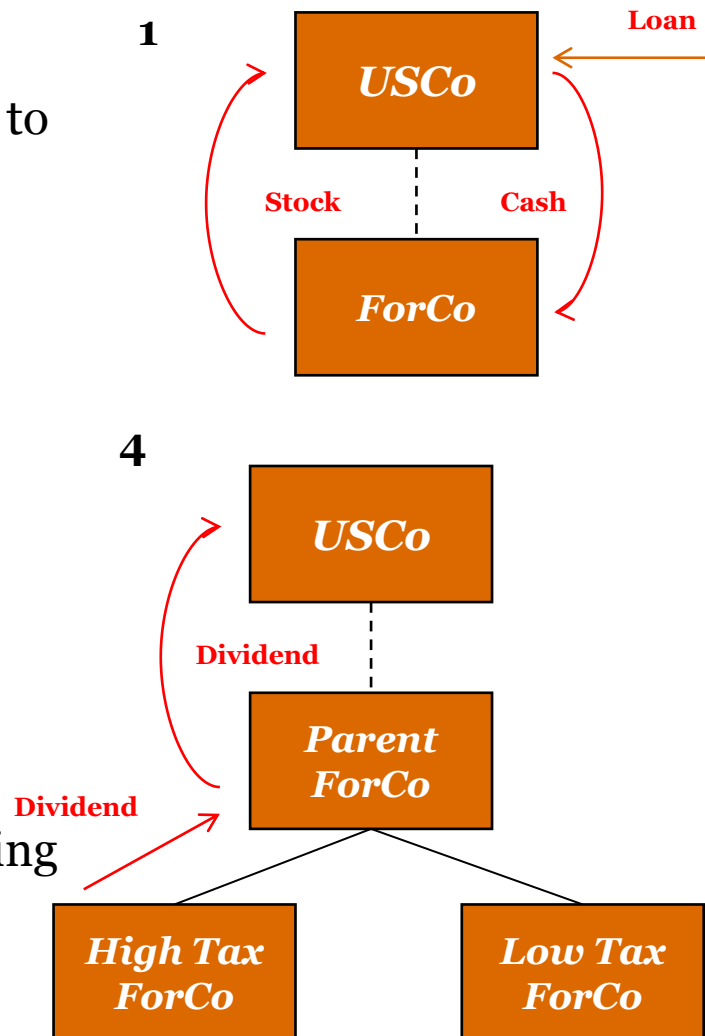
IRS Audit Activity

- *Increased focus on auditing multinationals*
- *Transfer pricing and permanent establishment issues are closely examined*
- *New debt vs. equity IDRs*



Proposed International Tax Legislation – Obama Administration

1. Defer deduction of interest expense related to deferred income of foreign subsidiaries.
2. Tax currently excess return associated with transfers of intangibles offshore.
3. Limit shifting of income through intangible property transfers.
4. Determine the foreign tax credits on a pooling basis.



Proposed International Tax Legislation – Obama Administration

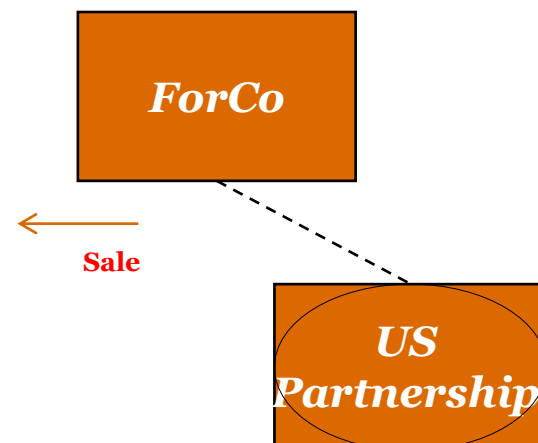
5. Limit earnings stripping by expatriated entities.

6. Gain on the sale of a partnership interest.

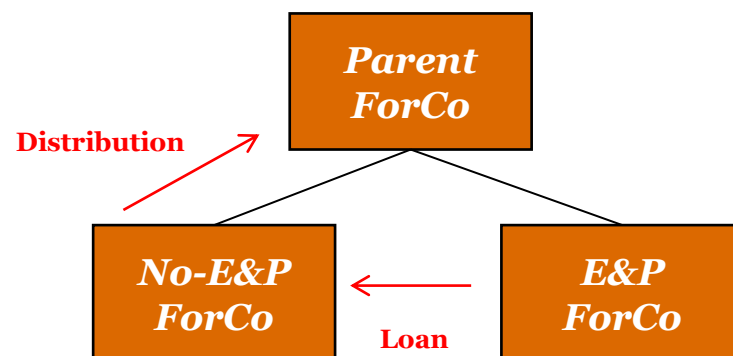
7. Prevent use of leveraged distributions from related foreign corporations to avoid dividend treatment.

8. Remove foreign taxes from a section 902 corporation's foreign tax pool when earnings eliminated

6



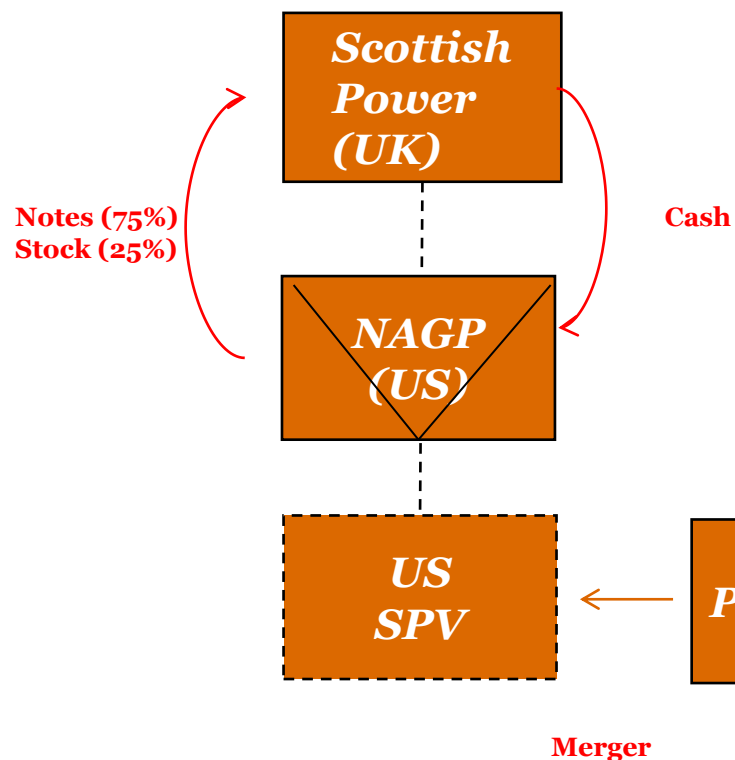
7



International Tax Reform – Territorial System

1. Corporate Tax Rate – Flat 25%.
2. DRD - 95 percent dividend received deduction for qualified foreign source dividends.
3. Subpart F income – similar to present law (Section 956 will be repealed).
4. Foreign Tax Credits – only direct foreign tax credits are creditable (and FTC with respect to Subpart F income).
5. Gain on the sale of CFC is 95% exempt.
6. Complicated transition rules and anti-avoidance rules.

Recent Cases – Debt vs. Equity



Scottish Power - Inbound Finance (NAGP v. Commissioner)

1. NAGP was financed with fixed-rate and floating-rate notes.
2. It was expected that interest payments would be funded with dividend distributions.
3. Certain interest payments were funded with short-term loans from Scottish Power and from the bank.
4. The floating-rate notes were capitalized into equity. The fixed-rate notes were partially capitalized.

Recent Cases – Debt vs. Equity

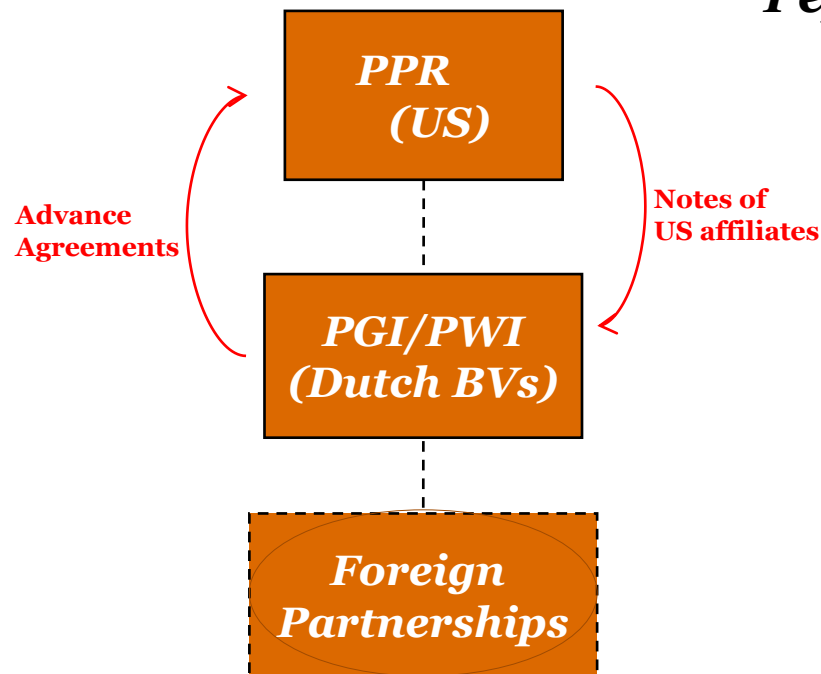
- ***Scottish Power – Tax Court Analysis***

The Tax Court applied the traditional debt *vs.* equity analysis, and decided that the advances made by Scottish Power to NAGP constituted ***debt***. The Court examined the following factors to determine whether the instrument was more appropriately characterized as debt or equity:

1. Source of payments.
2. Subordination.
3. Intent of parties.
4. Adequate capitalization.
5. Ability to obtain outside financing.

Recent Cases – Debt vs. Equity

PepsiCo - Outbound Finance



1. PPR was a Delaware corporation that elected the benefits of section 936.
2. PepsiCo intended for the advance agreements to be treated as debt in the Netherlands and as equity in the US.
3. Lengthy negotiations with the Dutch tax authorities. No obligation to make annual interest payments.
4. 40-years term with an option to renew. The advance agreements will become perpetual if the affiliates default on the notes.
5. Preferred Return (it was expected that PGI and PWI will have no earnings and profits).

Recent Cases – Debt vs. Equity

- ***Pepsico – Tax Court Analysis***

The Tax Court applied the traditional debt *vs.* equity analysis, and decided that the advances agreements constituted ***equity*** for US federal income tax purposes. The Court examined the following factors to determine whether the instrument was more appropriately characterized as debt or equity:

1. Subordination.
2. Source of payments.
3. Right to enforce payment.
4. Fixed maturity date.
5. Other factors: ability to obtain outside financing, thin capitalization, and parties' intent.

- Compare ***Pepsico*** to ***Hewlett-Packard*** – Similar facts, same judge, different results.

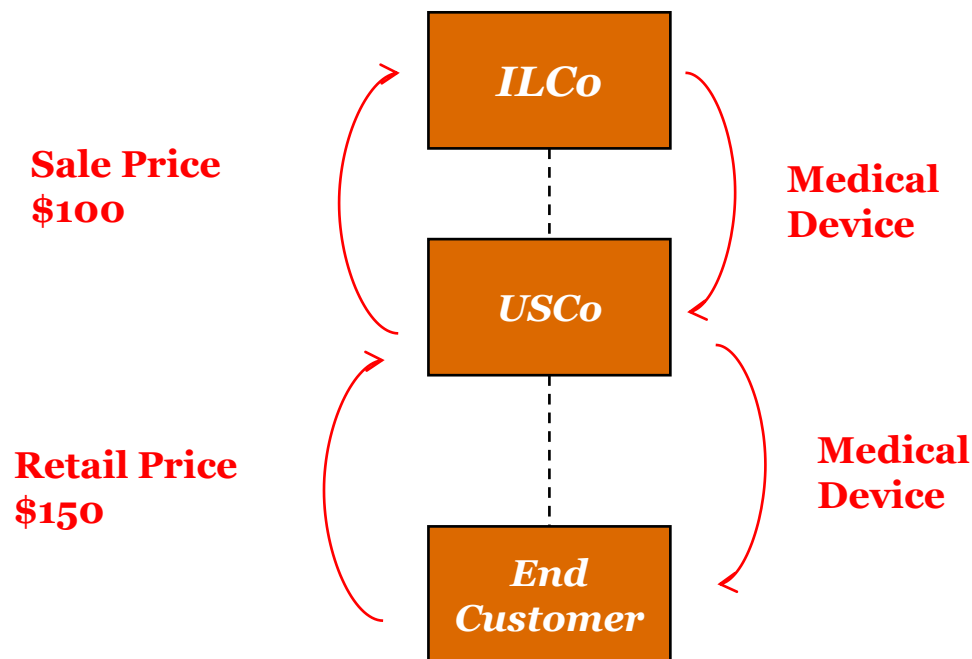
Medical Device Excise Tax

In General

1. Section 4191 imposes an excise tax on the sale of certain medical devices by the manufacturer, producer, or importer of the device.
2. Tax rate – 2.3 percent of the sale price. Applies to sales of medical devices after December 31, 2012.
3. The excise tax is a one-time tax that attaches when the title to the taxable article passes from the manufacturer (or importer) to a purchaser.
4. A product is a taxable medical device if it is a device intended for humans that meets the definition of “device” in the Federal Food, Drug and Cosmetics Act.
5. Broad definition of “Device”.
6. Exception for eyeglasses, contact lenses and hearing aides.

Medical Device Excise Tax

What is the Adjusted Price?



Inversion – New Regulations

In General

Section 7874 applies when a foreign corporation acquires substantially all of the properties of a domestic corporation or partnership, and:

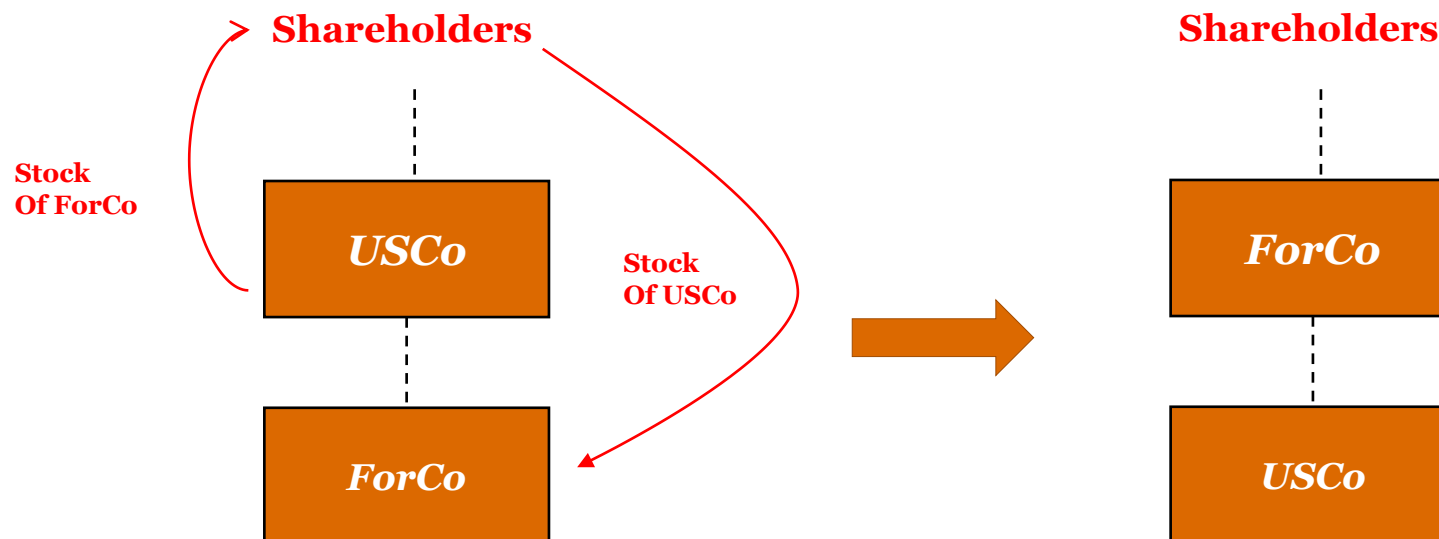
1. The S-Hs/partners receive at least 80% of the foreign corporation's stock → the foreign corporation is treated as a domestic corporation, OR
2. The S-Hs/partners receive at least 60% of the foreign corporation's stock → limitations on the use of tax attributes by the domestic corporation.

An exception applies if the group conducts substantial business activities in the foreign corporation's country of organization (the **“substantial business activities” exception**).

Inversion – New Regulations

New Regulations

New regulations under section 7874 require that, in order to meet the substantial business activities exception, the group must have at least 25 percent of its employees, property and income in the foreign country.



FATCA

In General

1. Generally, the FATCA rules require foreign financial institutions (“**FFIs**”) to enter into agreements with the IRS to share information with respect to US account holders.
2. Non-financial foreign entities (“**NFFE**s”), to whom certain US source payments are made, are also required to disclose substantial US ownership **or** demonstrate that they are excepted from the application of the rules.

Withholding Tax (effective as of 1.1.2014)

The price for failure to comply - 30% withholding tax on certain payments made to: (1) FFIs that did not enter into an agreement with the IRS, and (2) NFFEs that fail to provide the information re level of US ownership.

FATCA – Proposed Regulations

Exceptions that Apply to NFFE

1. Pre-2013 obligations.
2. The NFFE certifies to the withholding agent that it has no “substantial US owners”, i.e., more than 10% direct or indirect interest.
3. The NFFE provides the withholding agent with the name, address, TIN of each substantial US owner.
4. Certain NFFEs are excepted under the regulations, including:
 1. Publicly traded corporations and certain affiliates,
 2. Exempt beneficial owners, and
 3. Active NFFE – less than 50% of its gross income and its assets are passive.

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 advisors.
- 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.

Circular 230: this document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties that may be imposed on the taxpayer.

Thank you!

Doron Sadan, Tax Partner, PwC Israel

03-7954460

doron.sadan@il.pwc.com

Tzachi Schwartz, Senior International Tax Manager, PwC Israel

03-7954811

Tzachi.schwartz@il.pwc.com

PwC firms provide industry-focused assurance, tax and advisory services to enhance value for their clients. More than 162,000 people in 154 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice. See www.pwc.com for more information.

"PwC" is the brand under which member firms of PricewaterhouseCoopers International Limited (PwCIL) operate and provide services. Together, these firms form the PwC network. Each firm in the network is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way.

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, Kesselman & Kesselman, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.



©2011 Kesselman & Kesselman. All rights reserved.

In this document, "PwC Israel" refers to Kesselman & Kesselman, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.