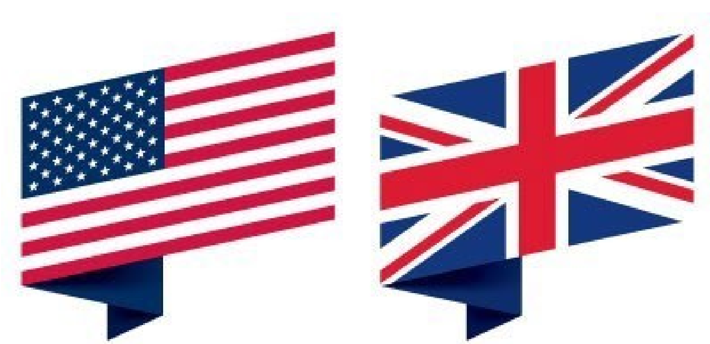
Joint Meeting of the UK and US Branches of the International Fiscal Association

US Outbound/UK Inbound Investment



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Agenda

Key considerations

- US Foreign Tax Credit Changes
- Tax Residency Matters
- Tax Treaty Eligibility
- UK CFC and Base Erosion Rules
- Inflation Reduction Act
- UK Debt Deductibility and Debt Push Down
- Summary of 7874/367/Anti-Inversion Rules
- UK QAHC Regime
- UK Stamp Duty
- UK VAT

Case Studies

- U.S. Take Private of a U.K. Listed Company
- Horizontal Double Dummy

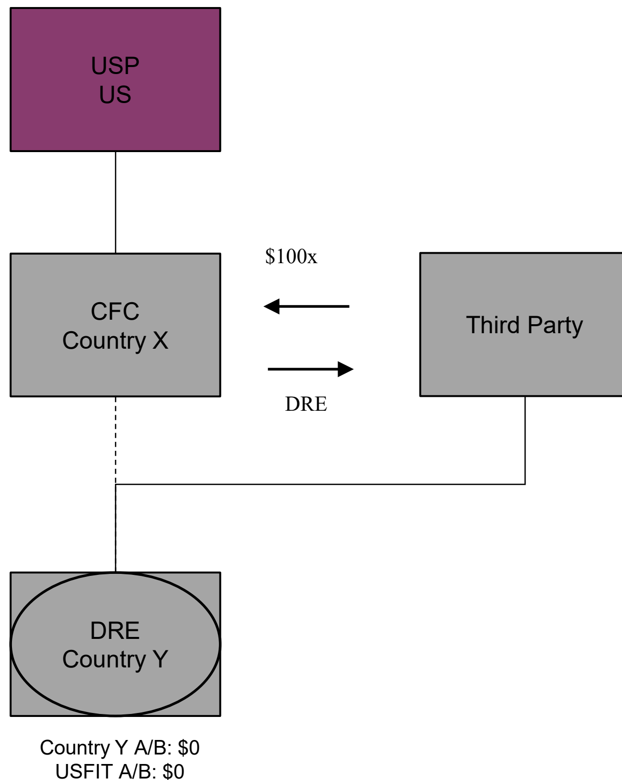
Key Topics: US Foreign Tax Credit Changes

- On December 28, 2021, the U.S. Treasury published final regulations addressing matters regarding foreign tax credits (TD 9959) (the "Final Regulations"). The Final Regulations generally finalized the proposed foreign tax credit regulations released on November 12, 2020 (REG-101657-20) (the "Proposed Regulations").
- The Proposed Regulations introduced new requirements for a foreign tax to be creditable under sections 901 and 903, including the addition of a jurisdictional nexus requirement and changes to the net gain requirement.
- These rules will limit foreign tax credits for foreign taxes that were creditable under prior law. The rules limit foreign tax credits to foreign income taxes that conform to U.S. tax law. In particular, the rules force conformity with respect to the application of the arm's length principle, the allowance of deductions, and the sourcing of income earned by non-residents.
- For example, withholding taxes on services and royalties imposed on the basis of the residence of the payor or on a similar basis will not be creditable except when imposed directly on a U.S. taxpayer that benefits from a U.S. tax treaty that permits a credit.

Key Topics: US Foreign Tax Credit changes – Attribution Requirement for Capital Gains Taxes

- Under Reg. section 1.901-2, a foreign tax must satisfy the “attribution requirement” (formerly known as the jurisdictional nexus requirement) of Reg. section 1.901-2(b)(5) to be a creditable foreign income tax.
- For sales of property by non-residents, including shares of a corporation or an interest in a partnership or other pass-through entity, a foreign tax based on the situs of the property satisfies the attribution requirement only if:
  - (i) the amount of gross receipts from the sale or disposition of property that is included in the base of the foreign tax on the basis of the situs of real property may only include gross receipts that are attributable to the disposition of real property situated in the foreign country imposing the foreign tax (or an interest in a resident corporation or other entity that owns such real property) under rules reasonably similar to the rules in section 897; or
  - (ii) the amount of gross receipts from the sale or disposition of property other than shares in a corporation, including an interest in a partnership or other pass-through entity, that is included in the base of the foreign tax on the basis of the situs of property other than real property may only include gross receipts that are attributable to property forming part of the business property of a taxable presence in the foreign country imposing the foreign tax under rules that are reasonably similar to the rules in section 864(c).
- Is there a rule for non-resident CG tax from sale of shares in a corporation, where foreign tax is not based on real property situs?

Property-based Attribution Requirement: Example



- USP wholly owns CFC in Country X, which wholly owns DRE in Country Y.
- CFC sells DRE to a third party buyer for $100x.
- As CFC is a nonresident, CFC is subject to Country Y's nonresident capital gains tax on the sale.
- Assumptions:
  - No Country Y real property in DRE
  - USFIT GILTI Effective Rate: 10.5%
  - Country Y's nonresident Capital Gain Tax Rate: 20%
  - CFC is eligible for Country X's 100% participation exemption on the sale of DRE
- Result: $28.40x tax on sale ($20x tax in Country Y + $8.40x US tax). No U.S. FTC available under Treas. Reg. section 1.901-2(b)(5)(i)(C) (but Country Y tax is a deductible expense for purposes of determining U.S. capital gain tax).

Key Topics: Tax Residency Matters

- Important to consider whether a company will be considered UK tax resident/non-UK tax resident
  - UK resident company subject to UK corporation tax on all of its worldwide profits
  - Incorporation test
    - UK incorporated companies are resident in the UK.
  - Central management and control ("CMC")
    - Where the highest level of control of the company is conducted.
    - Question of fact.
    - Consider the whole course of the company's business.
    - Particular factors to consider:
      - Control by directors – not necessarily where the directors meet, but where the directors in fact carry out the highest level of control of the company.
      - Do the directors actually make decisions, or do they merely rubber stamp?
      - Control by parent company?

Key Topics: Tax Residency Matters

- HMRC v Development Securities plc [2020] EWCA Civ 1705:
  - "[T]he question is not why the directors made the decision they did, or how much thought they gave to it, or what they did or did not take, or should or should not have taken, into account. The question is a much simpler one, namely: did they make the decision?"
  - Location of CMC is highly fact-sensitive.

Key Topics: Tax Treaty Eligibility

- It may be necessary to rely on tax treaties in order to repatriate profit in the post-acquisition structure
- Principal purpose test
  - Established by the BEPS Project – aims to prevent aggressive tax planning.
- Simplified Limitation of Benefits
  - Objective criteria that restrict treaty benefits to “qualified persons”.

Key Topics: Tax Treaty Eligibility

- ATAD III – ‘EU Shell Companies Directive’
  - Could apply from January 2024 (with two year look back).
  - Imposes reporting obligations.
  - Denies access to tax treaties and EU directives.
  - 5% (of turnover) penalty for non-compliance.
- US LOB Changes
  - The 2016 Model Treaty added derivative benefits and headquarters tests.

Key Topics: UK CFC and base erosion rules

- Likely that entities acquired by or sitting below a UK holding company will be UK CFCs.
- Charge on profits of companies controlled by a UK resident person or persons.
- Profits must pass through a gateway to be chargeable:
  - General business profits.
  - Specific profit types.

Key Topics: UK CFC and base erosion rules

- Entity level exemptions:
  - Exempt period exemption.
  - Excluded territories exemption.
  - Low profits exemption.
  - Low profit margin exemption.
  - Tax exemption.
- United Kingdom and ITV v Commission (T-363/19 and T-456/19) – group financing profits exclusion from chargeable profits.

Key Topics: UK CFC and base erosion rules

- In line with the BEPS Project, the UK has a number of rules to prevent base erosion:
  - Diverted profits tax:
    - Aimed to counter the use of aggressive tax planning to divert profits from the UK to reduce tax burden.
    - Can apply where trade is carried on in the UK, but a UK permanent establishment is intentionally avoided.
    - Various thresholds which a company must exceed before DPT may apply.

Key Topics: UK CFC and base erosion rules

- Base erosion rules (cont.)
  - Offshore Receipts in respect of Intangible Property
    - Introduced in April 2019.
    - Targets arrangements where profits from intangible property through UK sales are received in an offshore low-tax jurisdiction.

Key Topics: Inflation Reduction Act Summary

- On August 7, 2022, the U.S. Senate passed legislation (H.R. 5376) that includes significant tax law changes (the "Inflation Reduction Act"). The Inflation Reduction Act is a reconciliation bill; all 50 Senate Democrats voted for the legislation and all 50 Senate Republicans voted against it, with Vice President Harris casting the tie-breaking vote in favor of the Act.
- As noted above, the Inflation Reduction Act includes several tax revenue raising provisions, although the Act is significantly smaller than the reconciliation bill passed in November 2021 by the U.S. House of Representatives (the "House"), known as the "Build Back Better Act." The House passed the Inflation Reduction Act on Friday, August 12, on a 220-207 partisan vote.
- President Biden signed the Act into law on August 16, 2022.

Key Topics: Inflation Reduction Act Summary - Excise Tax on Stock Repurchases

- The Act introduces a new 1% excise tax on the fair market value of stock “repurchased” by publicly traded U.S. corporations.
- For purposes of this excise tax, a “repurchase” is defined broadly and covers transactions beyond the traditional, open-market stock buybacks. More specifically, the term “repurchase” generally means a “redemption” within the meaning of Section 317(b) and essentially includes any transaction where the corporation acquires its stock from a shareholder in exchange for property (including cash) other than the corporation’s own stock or rights to acquire its own stock.
- There are, however, several exceptions to the application of this new tax. These include: (i) repurchases by real estate investment trusts and regulated investment companies, (ii) repurchases treated as dividends, (iii) repurchased stock that is contributed to an employee pension fund, ESOP or similar plan, (iv) repurchases that are part of a tax-free reorganization, provided the shareholder does not recognize any gain or loss by reason of such reorganization, (v) repurchases where the total value of the stock repurchased during the tax year does not exceed $1 million, and (vi) repurchases by dealers of securities in the ordinary course of business under regulations to be issued by Treasury and the IRS.

Key Topics: Inflation Reduction Act Summary – Corporate Alternative Minimum Tax

- The Inflation Reduction Act introduces a new 15% corporate alternative minimum tax (the "Corporate AMT") on the "adjusted financial statement income" ("AFSI") of an "applicable corporation."
- Generally, an "applicable corporation" is any corporation or group of corporations treated as a single employer (other than any real estate investment trust, regulated investment company or S corporation) whose average annual AFSI in the three tax years ending prior to the current taxable year and after December 31, 2021, exceeds $1 billion.
- The $1 billion threshold is reduced to $100 million for corporations that are part of a foreign-parented multinational group with AFSI exceeding $1 billion. Once a corporation is treated as an applicable corporation, it will remain an applicable corporation for all future years, absent certain limited exceptions.

Key Topics: Inflation Reduction Act Summary – Other Provisions

- The Inflation Reduction Act increases IRS funding by $76.6 billion, including approximately $46.6 billion for tax enforcement activities, $25.3 billion for operations support, $4.75 billion for upgrading technology and business systems services, and $3.2 billion for taxpayers services.
- The Inflation Reduction Act includes many of the same, or similar, incentives for clean energy investments that were proposed in the Build Back Better Act.

Key Topics: UK Debt Deductibility and Debt Push Down

- If raising acquisition debt, it is important to consider whether interest can be deducted from operating profits through grouping
- Debt deductibility restrictions:
  - Purpose based anti-avoidance rules
    - E.g. unallowable purpose – broad approach taken meaning that deductions for connected party (e.g. Finco structure) debt could be problematic.
  - Policy based anti-avoidance rules
    - E.g. anti-hybrid rules.
  - Mechanical
    - E.g. corporate interest restriction (interest deductibility limited to 30% EBITDA).
  - Mechanical/anti-avoidance rules
    - E.g. Transfer pricing – transactions at arm's length.

Key Topics: UK Debt Deductibility and Debt Push Down

- Debt Deductibility restrictions (cont.):
  - Reclassification
    - E.g. profit linked returns treated as a distribution.
  - Other anti-avoidance rules
    - E.g. General anti-avoidance rule (GAAR), case law.
- HMRC v BlackRock Holdco 5, LLC [2022] UKUT 00199
  - Unallowable purpose: broad approach taken meaning that deductions for connected party (e.g. Finco structure) debt could be problematic.
  - Transfer pricing: total disallowance of interest where third party would not have lent without certain covenants.
  - Appeal likely.

Key Topics: Brief Discussion on US Anti-Inversion Rules

- Section 367
  - Key Rule: Generally, the U.S. SPAC's shareholders must receive ≤50% of the resulting foreign parent corporation.
  - GRA needed for any U.S. SPAC shareholder that receives ≥5% of the stock of the resulting foreign parent corporation and is a U.S. person .
  - Sleeper issue: Must comply with Section 367's active trade or business requirement (may be particularly relevant if Foreign Target is a start-up, has a short history and/or no revenues yet).

Key Topics: Brief Discussion on US Anti-Inversion Rules

- Section 7874
  - Foreign acquiring corporation will be treated as a U.S. corporation for all U.S. tax purposes if (i) the shareholders of the U.S. SPAC receive ≥80% (by vote or value) of such foreign acquiring corporation by reason of owning U.S. SPAC shares and (ii) the foreign acquiring corporation flunks the "substantial business activities" test
    - Substantial Business Activities: ≥ 25% of revenues, tangible assets, and employees (by headcount and total compensation) of the resulting foreign parent corporation's "expanded affiliated group" take place in / are located in such foreign parent's country of incorporation and is a tax resident of such country (unless such foreign country does not impose a corporate income tax).
    - Ownership Test – < 60%: Shareholders of the U.S. SPAC receive <60% (by vote and value) of the resulting foreign parent corporation's stock by reason of owning U.S. SPAC shares.
    - "Limited Inversion" Status: Shareholders of U.S. SPAC receive ≥60% (by vote or value), but <80% (by vote and value), of resulting foreign parent corporation by reason of owning U.S. SPAC shares
      - Numerous adverse post-deal consequences.
    - Complex counting rules take into account / require deemed adjustments for distributions, issuances and redemptions in the 3-year pre-closing period
      - Special rules for Warrants – Generally treats the "in-the-money" value as deemed stock for purposes of the value threshold under Section 7874's ownership test.

Key Topics: UK QAHC Regime

- Enables the UK to be a suitable alternative to Luxembourg holding structures
  - Does not apply to REITs
  - Ownership conditions (aimed at funds):
    - At least 70% held by "category A" investors (aimed at funds and includes other QAHCs, qualifying funds, sovereigns, collective investment vehicles etc.).
  - Activity and investment strategy conditions
    - Investing in funds to spread investment risk.
    - Must not invest in listed securities or interests which derive value from listed equity positions.
- Special tax regime:
  - Broad capital gains tax exemption.
  - Exemption from UK WHT on payments of interest.
  - Deduction of interest on profit related debt instruments.
  - Capital treatment of premiums on a share buy-back.

Key Topics: UK Stamp Duty

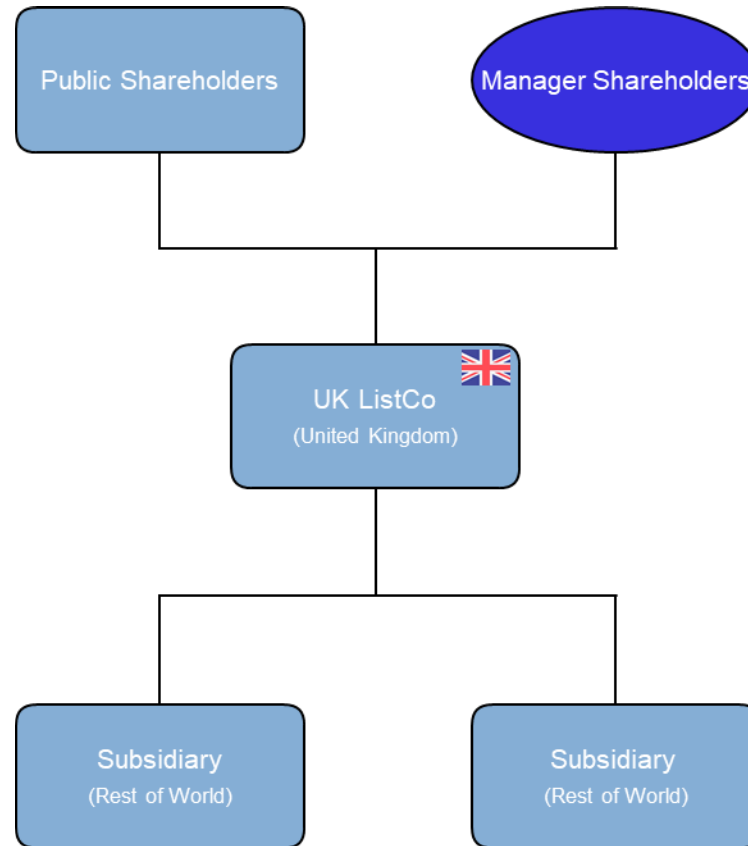
- In private deals, stamp duty is generally paid, while historically stamp duty on public deals was mitigated
- Stamp duty issues of public takeovers:
  - Previous mitigation techniques (swamping schemes and cancellation schemes) no longer work.
  - Some mitigation continues to be available where shares held in depositary/clearance services (e.g. ADRs).

Key Topics: VAT

- Break fees will generally be subject to VAT if the underlying supply would have been subject to VAT.
- Although there is some doubt, break fees on share deals should not generally be subject to VAT.
- If VAT is payable on break fees, it is unlikely to be recoverable.

Case Study: U.S. Take Private of a U.K. Listed Company

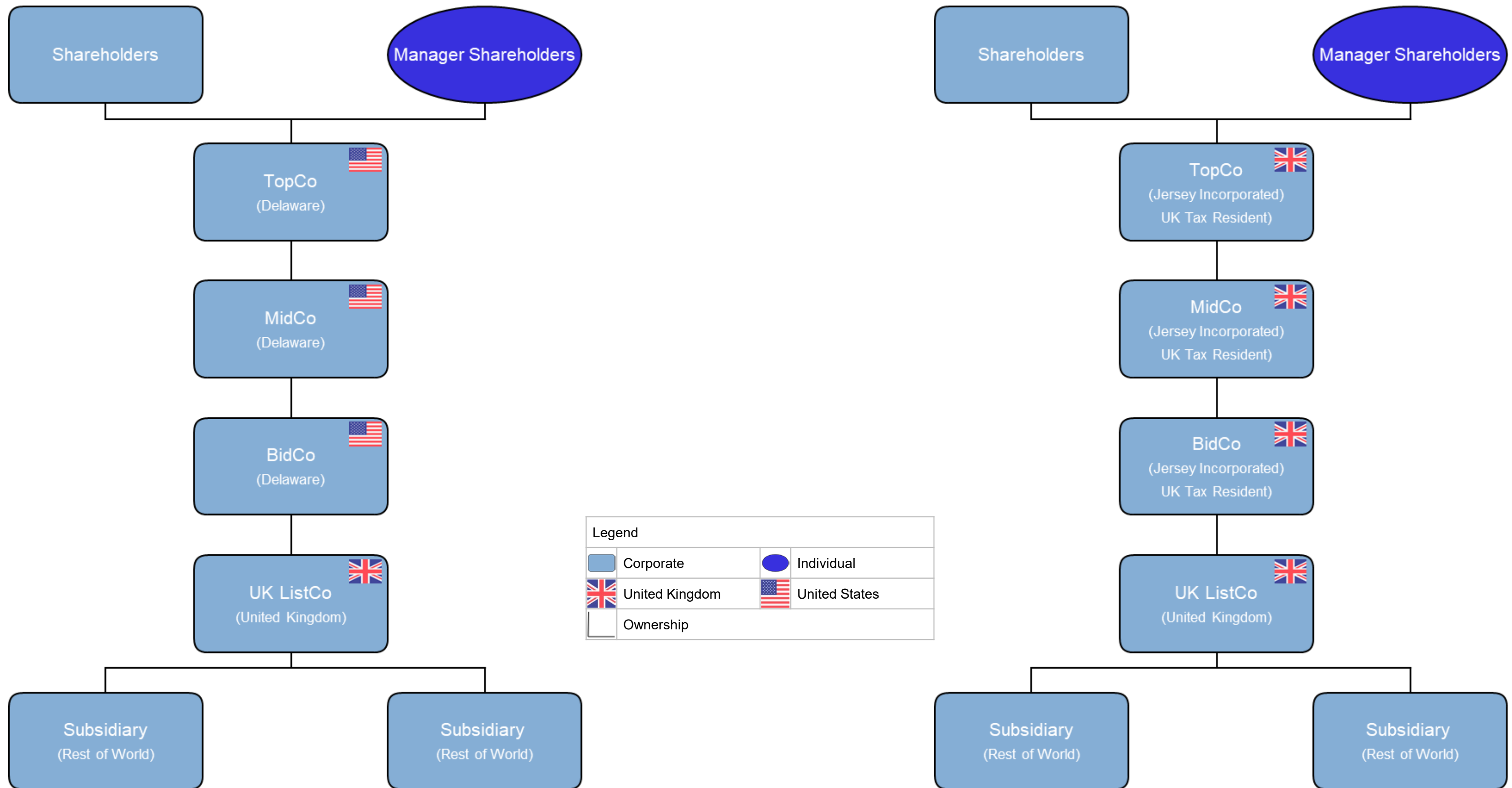
- Typical UK Listed Company Structure



Legend	
Corporate	Individual
United Kingdom	United States
Ownership	

Case Study: U.S. Take Private of a U.K. Listed Company

- Typical Post-Acquisition Structures



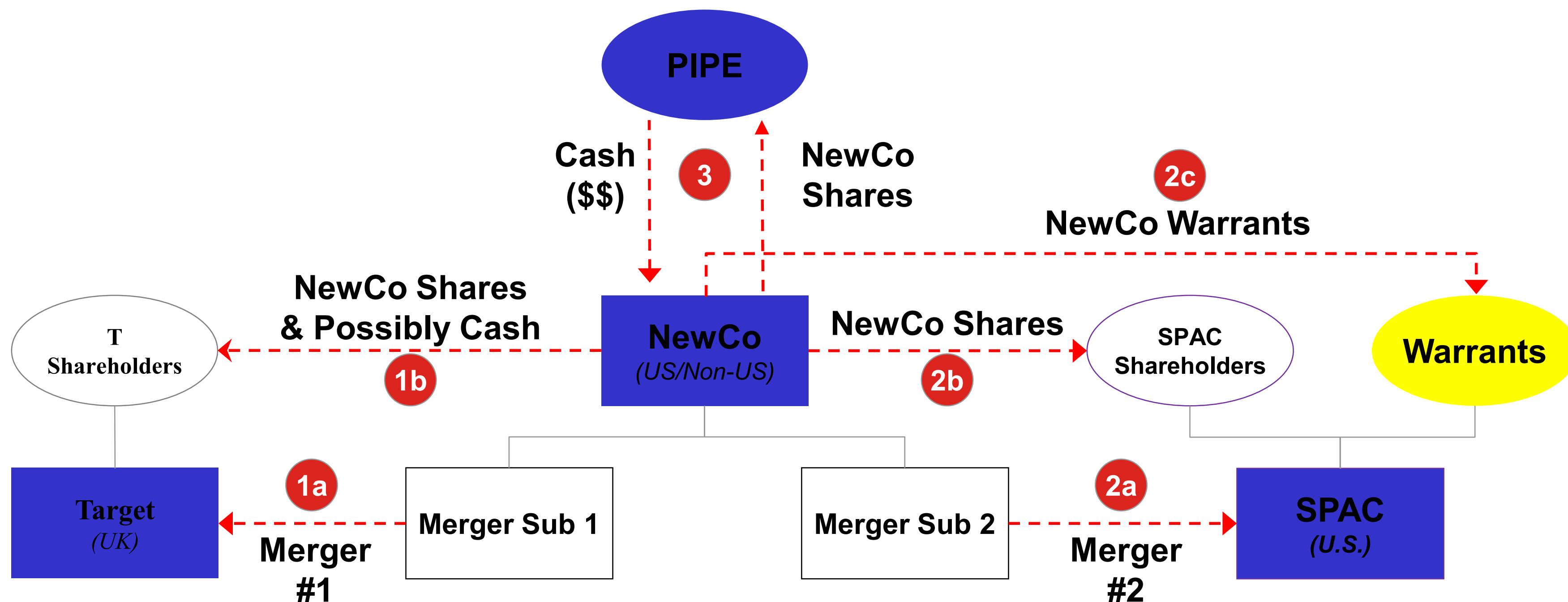
Case Study: U.S. Take Private of a U.K. Listed Company

- Typically carried out by way of a scheme of arrangement
- Key considerations:
  - Stamp duty
    - Ensure court order is not stampable to avoid timing implications
    - Where and how are the shares held?
    - If held in a depositary/clearance service, stamp duty mitigation might be possible.
    - Extra-statutory clearance may take longer to acquire.
  - Management
    - Rollover of management shares to TopCo.

Case Study: U.S. Take Private of a U.K. Listed Company

- Key considerations (cont.):
  - Ongoing taxation
    - Consider UK CFC rules.
    - Possible restrictions on use of losses after a change of control.
  - Profit repatriation
    - Consider treaty access.
    - Some jurisdictions are more likely to allow treaty access on payments to a listed parent.
  - Should Bidco be a QAHC?
  - Financing
    - Debt pushdown for acquisition debt?
    - UK WHT mitigation?

Case Study: Horizontal Double Dummy



- **Transaction is intended to qualify as a valid Section 351 transaction**
  - Section 351: Transfer of property to a corporation (here, NewCo) where the transferors, *in the aggregate*, receive stock representing (i) ≥ 80% of the voting stock and (ii) ≥ 80% of any class of nonvoting stock – clearly met here ("Section 368(c) Control").
  - No COBE issue; similarly, other reorganization requirements are not applicable.
  - Ensures transaction will be tax-free to SPAC shareholders (subject to Section 367).
- **But, unlike in a reorganization, the receipt of warrants is not tax-free in a Section 351**
  - Relevant here because in the traditional double dummy, all of the depicted stakeholders are transferring property to NewCo, including SPAC's warrant holders – warrant treatment can be especially important for Sponsor.
- **Section 351 qualification does not preclude taxpayer from making the argument that the SPAC merger (Merger #2) is a valid reorganization (if and when you conclude you will satisfy COBE and any other applicable requirements).**