www.pwc.com

Guide to taxation of US LLCs presented by PwC

October 2018

pwc

Table of contents

This guide is current as of October 2018, and is not updated regularly.

What is an LLC?

A Limited Liability Corporation (LLC) is formed and operated under state law and is widely used by taxpayers for both tax and non-tax benefits. LLCs offer flexibility because unincorporated entities, like LLC's, can choose to be taxed as a disregarded entity (also referred to as a sole proprietor if LLC is owned by an individual), corporation, or as a partnership.

An LLC is a hybrid entity that combines several of the advantages of operating as either a partnership or a corporation. In contrast to a limited partnership (LP), which must have at least one general partner with personal liability, all the members in an LLC have limited liability (a factor that resembles a corporation or limited partners of a limited partnership). Furthermore, an LLC can be formed with only one owner, whereas a partnership requires at least two owners.

Note that an 'owner' of an LLC can also be referred to as a partner, member, or investor for purposes of this Guide.

The LLC structure also provides the flexibility to decentralize the management structure without the participation of all of its members and designate managers to manage the business. Additionally, there is also no limit to the number of owners and the type of owners, unlike S corporations.

If there is only one member in the LLC, the LLC is treated as a "disregarded entity" for tax purposes, and would report the LLC's income on their applicable tax return; for example, an individual owner would report the LLC's income or loss on his or her US individual tax return, Form 1040 or 1040NR. Thus, income from the LLC is taxed at the individual tax rates. The default tax status for LLCs with multiple members is a partnership, which is required to report income and loss on IRS Form 1065. Under partnership tax treatment, each member of the LLC, as is the case for all partners of a partnership, annually receives a Form K-1 reporting the member's distributive share of the LLC's income or loss that is then reported on the member's income tax return. An LLC that is treated as a partnership may specially allocate the members' distributive share of income, gain, loss, deduction, or credit via the company operating agreement on a basis other than the ownership percentage of each member as long as certain Treasury Regulations are met.

Note IRS Form SS-4 will include entity classification information.

For US federal income tax purposes, an LLC can elect to be taxed as a C corporation or S corporation (as long as they would otherwise qualify for such tax treatment). Election decisions are typically based on legal and tax considerations.

For Federal taxes, there is no "LLC taxation" class. LLCs are taxed like existing businesses. The 4 business types are: disregarded entity Partnership (limited partnership); C-Corporation; and S-Corporation.

The LLC Default Tax Classification (meaning unless a different tax election is requested with the IRS) is taxation based on number of members:

- An LLC with one owner is called a single-member LLC, and the IRS taxes single-member LLCs like a Sole Proprietorship if the owner is an individual. If the single owner is a C-Corporation, the IRS will tax the LLC at the C-Corporation level on Form 1120.
- An LLC with two or more owners is called a multi-member LLC, and the IRS taxes multi-member LLCs like a Partnership.
- Sole Proprietorship, disregarded entity and Partnership taxation are "pass-through", meaning the business profits, losses, credits, and deductions will flow through to the tax return of each member.
- An LLC taxed as a Partnership must also file a 1065 partnership return and issue K-1s to the LLC owners.
- An LLC can also elect to be taxed as an S-Corporation or a C-Corporation. We'll discuss these within this Guide.

When foreign companies (persons) are investing in the US, they should be aware of the potential US tax implications for the foreign entity interacting with the US. While the US tax consequences of the US LLC are described throughout this Guide, there are other tax considerations for a foreign company (person) to manage the US tax risk of the activities of the foreign company. Generally, foreign investors of US LLC's will have a US tax reporting and tax obligation in the US. Please see Appendix D in this Guide for further discussion.

For entity structuring considerations, LLCs can choose how to be taxed – either using the default tax treatment of a disregarded single member entity (where the tax reporting flows directly onto the sole owner's return) or as a multiple member partnership, or as a C Corporation or S Corporation if a formal election with the IRS is made. No other entity has this flexibility. Below is a summary chart on general comparisons for each entity:

	LLC (Multi Member)	LLC (Disregarded/ Single Member)	C Corporation	S Corporation	Limited Partnership
Liability	Generally limited to amounts invested and loaned. Owners of LLCs are not personally liable for the LLCs business debts.	Generally limited to amounts invested and loaned. Owners of LLCs are not personally liable for the LLCs business debts.	Generally limited to amounts invested and loaned. Owners of Corporations are not personally liable for the C Corporation's business debts.	Generally limited to amounts invested and loaned. Owners of S Corporations are not personally liable for the S Corporation's business debts.	Unlimited for general partners; limited partners possess limited legal liability and generally risk only their capital contributions to their limited partnership.
Double Taxation (Taxation at both LLC and Owner Level)	Generally No	Generally No	Yes. In general, income is taxed to the C Corporation and shareholders are taxed upon receiving distributions from the corporation.	Generally No	No
Pass – through of profits and losses from Entity to Owner	Yes	Yes	No	Yes	Yes
Ownership Limitations	Interests are offered to investors (can be foreign corporations or individuals, domestic corporations, trusts, and partnerships).	Single member owner (can be foreign corporations or individuals, domestic corporations, trusts, and partnerships)	No limitations on ownership	Investors generally can only be US citizens or residents. Limited to 100 owners/ members.	Interests are offered to investors (can be foreign corporations or individuals, domestic corporations, trusts, and partnerships).
Federal Tax Rates	Generally, income is taxed to owners at their marginal rates. (*Note self-employment taxes may also apply)	Generally, income is taxed to owners at their marginal rates. (*Note self-employment taxes may also apply)	Income is taxed to the corporation at a flat 21% rate and taxed again to owners upon distribution.	Income is taxed to owners at their marginal rates.	Income is taxed to owners at their marginal rates.
Taxable year	Generally, calendar year	Generally, calendar year	Any fiscal year or calendar year. Once calendar taxable year has been established, need business purpose to change to fiscal year.	Generally, calendar year	Generally, calendar year

Federal income tax

Who is subject to US Income Tax?

An annual US income tax return is required for a multi-member LLC. This applies to both US and foreign persons who have formed a US LLC.

An LLC is not considered separate from its partners for tax purposes. Generally, this means the partnership (the default tax-treatment for a multi-member LLC) itself does not pay any income taxes; instead, LLC income "passes through" the business to each partner, who then reports his or her share of business profits or losses on the applicable federal tax return. As owners of a pass-through business entity, partners in a partnership may qualify for the 20% pass-through tax deduction established under the Tax Cuts and Jobs Act.

As an LLC, what do I need to file?

LLCs with more than one member generally file a partnership return Form 1065 on an annual basis with the IRS. Included within Form 1065 is Schedule K-1; Schedule K-1 is a tax document issued to report member's share of the partnership's income, deductions and credits.

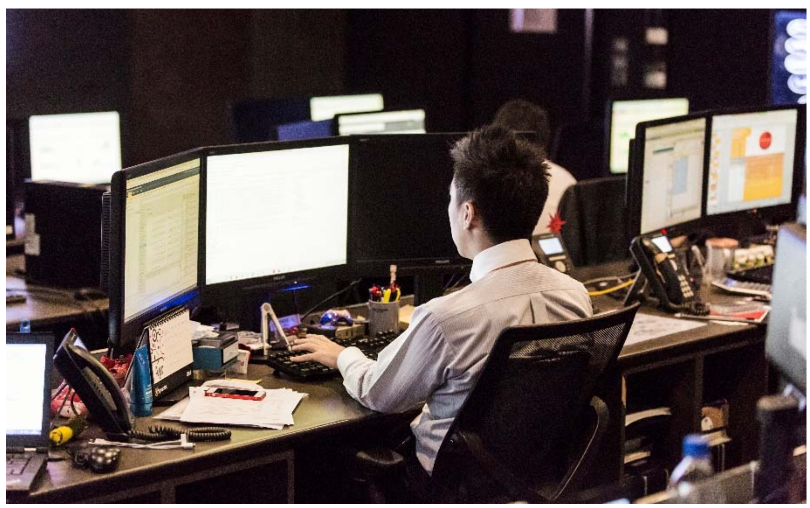
Single member (disregarded) LLC's generally do not have a separate federal filing requirement; instead, for example, a single member LLC who's member is an individual would report LLC income, deductions and credits on Schedule C of their individual US tax return (Form 1040 or Form 1040NR).

Note in addition to the Forms mentioned above, there are other informational forms that may be required. For example, Form 5472 (Information Return of a 25% Foreign-Owned US Corporation or a Foreign Corporation Engaged in a US Trade or Business), is required to be filed by a foreign-owned, US company. Please consult with your tax professional for more information.

For multi-member LLCs that are inactive (i.e. a newly formed LLC that might not have started doing business yet or an older LLC might have become inactive without being formally dissolved), the LLC might still be required to file a federal income tax return. Even if your LLC has no business activity, it is important to understand your LLC tax filing status and whether it is obligated to file a federal income tax return.

If the LLC elected to be treated as a corporation, normal corporate tax rules will apply to the LLC and it should file a Form 1120, US Corporation Income Tax Return (See "Stripe Atlas - PwC Corporate Guide to US Taxes" for further discussion on C Corporation filing requirements).

If a qualifying LLC elected to be treated an S Corporation, it should file a Form 1120S, US Income Tax Return and S corporation laws would then apply to the LLC.



As an Owner/Member of an LLC, what do I need to file?

If an LLC has only one member and is classified as an entity disregarded as separate from its owner, then the LLC's income, deductions, gains, losses, and credits are reported on the owner's income tax return. For example, if the owner of the LLC is an individual, the LLC's income and expenses would be reported on schedules within the owner's Form 1040. If the single member of the LLC is a C Corporation, then the LLC's activity would also be reported on the owner's (C Corporation) Form 1120.

If the LLC has multiple members, the activity is reported to the owners on Form K-1 (the owner/member receives the K-1 from the LLC). The member/owner then reports the K-1 activity on their income tax return, similar to the single member LLC reporting above.

As an Owner/Member, how much tax will I owe?

Your US LLC, for both multi and single member LLCs, will not be taxed at the LLC level, but will be taxed at the member level based on the distributive share amounts. The member pays taxes based on if they are an individual, partnership, or corporation. Each member's taxable income is subject to graduated higher tax rates ranging from 10% to 37% depending on the amount of taxable income if an individual, or at a flat rate of 21% if a corporation.

When do I have to file my taxes?

Multi Member LLC (no foreign members) & Multi Member LLC (at least one foreign member) - A partnership generally must file the annual tax return by the 15th day of the third month following the close of its tax year. A taxpayer can obtain a six-month extension to file its tax return, provided it's timely and properly files Form 7004.

Single Member LLC (Foreign) - LLCs Owned (owned 25% or more) by Foreign Persons Must File IRS Form 5472. A foreign person is defined by the IRS to include: an individual who is not a citizen or resident of the United States, an individual who is a citizen or resident of a US possession who is not otherwise a citizen or resident of the United States, any partnership, association, company, or corporation that is not created or organized in the United States. A reportable disregarded entity that has one or more reportable transactions with a related party during a tax year must file an IRS Form 5472 along with an IRS Form 1120. Form 5472 must be filed if a reporting corporation, including a foreign-owned single-member LLC, had a reportable transaction with a foreign or domestic related party. Reportable transactions include any amount paid or received in connection with the formation, dissolution, acquisition, and disposition of the entity. A single member LLC (foreign) must attach their Form 5472 to the reportable disregarded entity's annual pro forma Form 1120 by the 15th day of the fourth month following the close of the tax year. The only information required to be completed on Form 1120 is the name and address of the foreign-owned US disregarded entity and Items B and E on the first page. Item B is the US Employer Identification Number (EIN) of the LLC and Item E indicates if the 1120 is an initial return, final return, or if there has been an address or name change.

A single-member LLC owned by a foreign person is also generally required to report LLC income, deductions and credits on Schedule C of their individual US tax return (Form 1040NR) due by the 15th day of the fourth month following the close of the calendar year (or by the 15th day of the tenth month following the close of the calendar year if the return is on extension).

Single Member LLC (US) taxed as individual - A US individual must file their annual tax return (Form 1040) by the 15th day of the fourth month following the close of the calendar year.

LLC taxed as a C-Corporation - A corporation must file their annual tax return by the 15th day of the fourth month following the close of its tax year. See guide "Stripe Atlas - PwC Corporate Guide to US Taxes" for further details.

Is the foreign partner engaged in a US trade or business?

Beginning tax year 2017, US domestic LLCs that are wholly owned, directly or indirectly, by one foreign person (foreign person includes a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, a foreign estate, and any other person that is not a US person), are required to obtain a US tax identification number and file an annual return, on Form 5472, reporting transactions between the LLC and its foreign owner.

The LLC is still considered a disregarded entity for US tax purposes, but the information collected from foreign-owned LLCs will be available to the Internal Revenue Service (IRS) as it seeks to satisfy US obligations under its Foreign Account Tax Compliance Act (FATCA) intergovernmental agreements and, potentially, to be considered a Common Reporting Standard participating jurisdiction.

State income tax

What do I need to file?

Each state in the US has their own tax system that requires annual filings depending on your activity in the state. These filings are separate from the US federal return submitted to the Internal Revenue Service and are submitted to tax authorities of the individual states. The tax rates vary across the states but generally result in an additional income tax of up to 13.3%. Depending on the state, certain states will have both an LLC filing requirement (for both regarded and disregarded LLCs) and a member level requirement; some states will have no filing requirement and some only member level requirement.

Federal vs. State taxable income?

The starting point for determining US state taxable income generally is an entity's federal taxable income. However, there are several items that may be treated differently for state taxable income purposes (e.g., depreciation, state taxes paid, interest deductions and charitable contributions). The states will then apportion taxable income according to the company's relative presence in the state using various factors (e.g., sales, property, payroll, etc.).

Which states do I need to file?

A state generally may impose its tax on an entity to the extent a sufficient 'nexus' or taxable connection exists between the entity and the state. Each state has their own criteria for nexus but, in general, owning property, paying rent, or storing inventory in a state are examples of situations that would lead to a filing requirement in that state. Other factors, such as the location of employees and sales activity, can also be considered, depending on the state. Generally, an LLC will need to file in the state it is incorporated in and will likely need to file in any state where registered to do business.

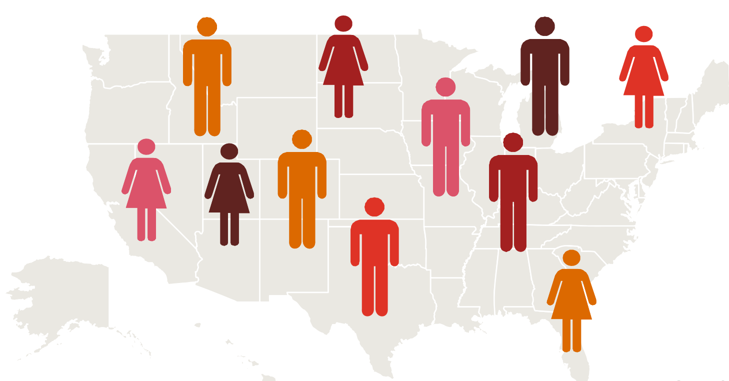
When are state taxes due?

Most states require the taxpayer to file their annual tax return by the 15th day of the third or fourth month following the close of its tax year. Some states permit a five or six-month extension to file their tax return, provided it's timely and properly files the extension form for that jurisdiction and deposits the full amount of any tax.

How can an LLC incorporated in one State do business in another?

If you're an LLC incorporated in one state and doing business in another state, your Company is considered domestic in the State incorporated and foreign in the state doing business (e.g. an LLC registered in Delaware and doing business in California).

If your business will have a physical presence by operating, hiring employees, banking or even holding an asset in the "foreign" state, you will typically need to qualify the business to operate there through a process known as Foreign Qualification. If this is something you are encountering or are planning to move forward with, please consult with your legal advisors.



Other state tax issues

States generally conform to federal income tax treatment with respect to inclusion of partnership items in state taxable income, guaranteed payments in state taxable income of the partner and treatment of preferred returns. However states do not conform to certain federal tax items like federal US tax treaties with foreign countries.

The United States has tax treaties with a number of foreign countries. Under these treaties, residents (not necessarily citizens) of foreign countries are taxed at a reduced rate, or are exempt from US taxes on certain items of income they receive from sources within the United States. Treaties, such as the US/UK treaty, expressly do not apply to state income taxes. Therefore, a state can tax income even if the US federal government is prohibited from imposing taxes on such income under the tax treaty. As this is a complex area, please consult with your tax professional for more information.

- Allocation –state source income is determined at the partnership level, with the partnership income apportioned only using the partnership apportionment factors. The partner receives a K-1 with the state source income amount already determined, and this predetermined amount is sourced directly to the state. The partner is then required, in many cases, to file a state tax return in the states they receive K-1s.
- Apportionment – corporate partner includes its share of the partnership's total income and apportionment factors in its own income and apportionment factors, and computes a combined apportionment factor at the partner level to determine state source income.

State allocation and apportionment varies from state to state. State treatment of entity type generally conforms to federal tax treatment with exceptions. Please consult with your tax professional for more information.

Transfer pricing

If you have multiple entities within your structure that interact with each other (e.g. subsidiaries under a parent company) and are subject to taxation in different jurisdictions, transfer pricing may be applicable to you. Transfer pricing may apply not only to cross border transactions internationally, but also within the US across states. Transfer pricing is a complicated area of taxation and therefore it is best to consult with your tax professional for more information.

Transfer pricing regulations govern how related entities set prices for the transfers of goods, intangible assets, services, and loans. The IRS (as well as several other countries) look to what is known as the arm's length standard to determine the appropriate price.

Generally, the arm's-length standard is met if the results of a related party transaction are consistent with the results that would have been realized had unrelated parties engaged in a similar transaction under similar circumstances. Assessing the arm's length nature of transactions involves careful analysis of the facts and circumstances surrounding the transaction. The analysis considers the functions performed, assets employed, and risks assumed by each of the parties in the transaction.

The IRS may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among the entities involved if it determines it is necessary to accurately reflect income or prevent evasion of taxes. Under certain circumstances, the IRS may impose penalties for incorrect transfer pricing. Preparing documentation of your transfer pricing positions contemporaneous with the filing of your US tax return can help you avoid penalties.

Examples of Transfer Pricing considerations

Foreign parent sells inventory to a US LLC which will be used in production of the inventory.

- Is the amount charged by the foreign parent the same amount that it would have charged to an unrelated third party?
- If the IRS determines the purchase price was not at 'arm's length,' then an adjustment will be required on the purchase price, potentially resulting in double taxation of the foreign parent and US LLC.

Foreign parent licenses software to be used by the US LLC

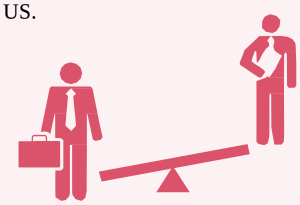
- What rate does the foreign parent charge the US LLC to use the software license?
- If the IRS determines the rate being charged is too high, when considering the 'arm's length' standard, the deduction taken in the US may be adjusted downward, resulting in the US LLC having additional taxable income in the US.

US LLC provides sales support to foreign parent, in the US

- Does the US charge the foreign parent for the services they are providing?
- If so, is the rate being charge appropriate under the 'arm's length' standard?
- If neither are considered, the IRS may consider an adjustment and impute income in the US for the services being provided, and the income would be taxable.

US LLC uses the name brand of the foreign parent

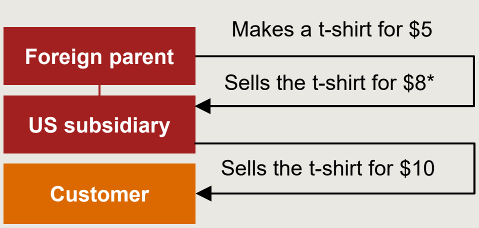
- What royalty payment does the foreign parent charge the US subsidiary for use of the brand name?
- If the IRS determines the rate being charged is too high, when considering the 'arm's length' standard, the deduction taken in the US may be adjusted downward, resulting in the US LLC having additional taxable income in the US.



Transfer pricing in practice

- A and B are related parties in different tax jurisdictions.
- Tax authorities can be concerned that differences between jurisdictional tax rules and rates create the opportunity for related entities to shift income from a higher tax jurisdiction to a lower tax jurisdiction (true for cross-border transactions both internationally and between states).
- To deal with this concern, transfer pricing regulations govern the price when items or services are transferred between related entities.

Example of how profits can be taxed



Entity	Sales	Cost	Profit
Foreign Parent	$8	$5	$3
US Subsidiary	$10	$8	$2

In this simplified example, the profit subject to tax in the US ($2) represents its sales less cost of purchasing the T-shirt. The US subsidiary may have other operating expenses that it can also deduct to further reduce taxable income.

*Price must be similar to what the foreign parent would charge to unrelated parties in the US

Other taxes

The United States has separate federal, state, and local government(s) with taxes imposed at each of these levels. Taxes are levied on income, payroll, property, sales, withholding, as well as various fees (see detailed descriptions of each below). These taxes are constantly evolving to keep up with new industries, to meet the changing needs of a state, or one of countless other factors. For example, on June 21, 2018, the US Supreme Court in *South Dakota v. Wayfair* overturned prior Court decisions and ruled that a physical presence is not required for the imposition of sales and use tax. This decision will have far-ranging tax and accounting impacts on companies, including LLC's. Therefore as a business owner/member, it is important to be aware of the constant changes, and account for them to reduce your potential risk.

Indirect Taxes

- An indirect tax (such as sales tax, per unit tax, value added tax (VAT), or goods and services tax (GST)) is a tax collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer). The intermediary later files a tax return and forwards the tax proceeds to government with the return.
- There is no VAT nor similar consumption tax. As a result, indirect tax is generally a state tax issue.
- The most common indirect tax is a state's sales and use tax, and franchise tax which is generally based upon capital.

Sales & Use Taxes

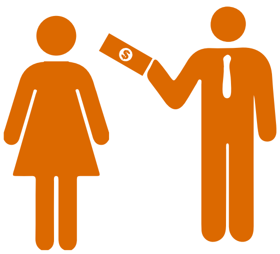
- Generally, once an entity has nexus to a state with respect to sales and use taxes, that entity must register with the state's tax department, file sales tax returns, and pay its sales tax liabilities.
- Depending on the volume of sales, the company may be required to file returns on an annual, quarterly, or monthly basis. Physical presence is not required for the imposition of sales and use tax by certain states.
- Generally, sales tax is imposed on retail sales, leases, rentals, barters, or exchanges of tangible personal property and certain enumerated services unless specifically exempted or excluded from tax.
- Sales tax generally is imposed in the jurisdiction in which the 'sale' occurs. The definition of 'sale' differs from jurisdiction to jurisdiction; however, the definition generally includes both (1) consideration and (2) transfer of title, right to use, or control (possession) in the case of tangible property and completion of the service act in the case of a service.

Delaware Franchise Tax

- LLCs have the following requirements:
- Any entity that is formed in Delaware (regardless of where you conduct business) must pay an Annual Tax for the privilege of incorporating in Delaware of $300 (as of 2018).
- Annual Taxes are due no later than June 1st of each year.

Failure to pay the required annual taxes will result in a $200 penalty plus 1.5% interest per month. LLCs that have elected to be treated as C-Corporations have a required Annual Report filing fee of $50 due March 1. Starting in 2018, the minimum tax is $175 for corporations using the Authorized Shares method and $400 for corporations using the Assumed Par Value Capital Method. Maximum Tax is $200,000 for both methods unless it has been identified as a Large Corporate Filer, then their tax will be $250,000. Please refer to the "Stripe Atlas – PwC Corporate Guide to US Taxes" for further information.

Other taxes *(continued)*



Payroll Taxes

- A payroll tax obligation will exist for a US entity if it has employees.
- All payments for employment within the US are wages subject to (1) federal income tax withholding, (2) Federal Insurance Contributions Act (FICA) taxes (i.e., social security and Medicare), and (3) the Federal Unemployment (FUTA) tax, unless an exception applies.
- The employer must pay and withhold social security taxes equal to 6.2% of wages for the employer and 6.2% for the employee, up to $128,400 of wages in 2018, and Medicare taxes equal to 1.45% for the employer and 1.45% for the employee. An additional 0.9% is also withheld on wages in excess of $200,000.
- The employer generally must file quarterly and annual employment tax returns and annual wage statements (Forms W-2) in its name and employer identification number, unless such statements are filed by a properly authorized third party.

Withholding and Self –Employment Taxes

- Individual LLC owners and members that are self-employed (i.e. not employees) are not subject to tax withholding, so each member must generally pay estimated taxes and self-employment taxes (Medicare and Social Security) quarterly to the IRS and applicable states. If an LLC owner or member is a Corporation, the Corporation must generally pay estimated taxes but is not subject to self-employment taxes. *Note S Corporations may or may not be subject to withholding taxes; please consult your tax advisor if this applies to you.
- An LLC with foreign partners could be responsible for complying with other filing requirements such as Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), Partnership Withholding, and NRA (Non Resident Alien) Withholding. If you are an alien (i.e. not a US citizen), you are considered a nonresident alien that may have an additional filing requirement unless you meet one of two tests: You are a resident alien of the United States for tax purposes if you meet either the green card test or the substantial presence test for the calendar year (January 1-December 31).

A partnership must pay the withholding tax for a foreign partner even if the partnership does not have a US taxpayer identification number (TIN) for that partner. Foreign partners must attach Form 8805 to their US income tax returns to claim a credit for their share of the IRC section 1446 tax withheld by the partnership. To insure proper crediting of the withholding tax when reporting to the IRS, a partnership must provide a US taxpayer identification number for each foreign partner. The partnership should notify any of its foreign partners without a valid TIN of the necessity of obtaining a US taxpayer identification number. An individual's taxpayer identification number is the individual's social security number (SSN) or individual taxpayer identification number (ITIN). An ITIN will always begin with a 9, and the middle two digits will be in the range of 70 to 80. It is also possible that a partner's TIN could be its US employer identification number (EIN).

Further guidance

For a more comprehensive discussion of US Taxation, please see the following section, "A guide to the key US tax issues."

Contact us

To schedule a discussion with a PwC professional on general US tax issues, please contact pwc@stripe.com

A guide to the key US tax issues

2018

Federal tax issues

For Federal taxes, there is no "LLC taxation" class. LLCs are taxed like existing businesses. The 4 business types are: Disregarded Entity (also referred to as single-member LLC or Sole Proprietorship; Partnership (limited partnership); C-Corporation; and S-Corporation.

The LLC Default Tax Classification (meaning unless a different tax election is requested with the IRS) is taxation based on number of members:

- An LLC with 1 owner is called a single-member LLC, and the IRS taxes single-member LLCs like a Sole Proprietorship.
- An LLC with 2 or more owners is called a multi-member LLC, and the IRS taxes multi-member LLCs like a Partnership.
- Both Disregarded Entity and Partnership taxation are "pass-through", meaning the business profits, losses, credits, and deductions will flow through to the tax return of each member; for example, if the member is an individual, the LLC activity would flow thru onto the member's Form 1040.
- An LLC taxed as a Partnership must also file a 1065 partnership return and issue K-1s to the LLC owners.
- An LLC can also elect to be taxed as an S-Corporation or a C-Corporation.

Taxes on Multi-Member LLCs and Single-Member, Disregarded LLCs

All US LLCs are subject to federal income taxes at the member level. US LLC members are taxed based on their distributive share of income. Generally, US taxable income is based on the member's portion of the LLC's gross receipts less various business expenses (e.g., cost of goods sold, salaries and wages). For a single member, disregarded LLC, this would be 100% of the LLC's activity reported at the owner's level.

For LLCs with multiple members, the LLC members are then allocated a portion of the income to be taxed. The US income tax rate is based on a progressive rate schedule if the member is an individual or a flat rate of 21% if a member is a corporation (this applies to both single member and multi-member LLCs).

2018 taxable income		US individual income tax		
Over ($)	But not over ($)	Pay ($) +% on excess		Of the amount over ($)
0	9,525	0	10	0
9,525	38,700	952.50	12	9,525
38,700	82,500	4,453.50	22	38,700
82,500	157,500	14,089.50	24	82,500
157,500	200,000	32,089.50	32	157,500
200,000	500,000	45,689.50	35	200,000
500,000		150,689.50	37	500,000

The computation of a partnership's (LLC's) taxable income is prescribed in Section 703(a). When reporting tax items, the partnership must distinguish tax items between those that are separately stated and those that are not separately stated to the partners.

Separately stated items

Separately stated items are items of income and deduction that can affect the computation of a partner's tax liability differently from another partner's liability. The eight categories of partnership income, gain, loss, deduction, and credit that must be separately stated on the partnership return pursuant to Section 703(a)(1) are:

1. Short-term capital gains and losses (Section 702(a)(1));
2. Long-term capital gains and losses (Section 702(a)(2));
3. Gains and losses under Section 1231 (Section 702(a)(3));
4. Charitable contributions (Section 702(a)(4));
5. Qualified dividend income taxed at capital gain rates under Section 1(h)(11) and dividends eligible for a deduction under Sections 243 through 247 (Section 702(a)(5); reg. section 1.702-1(a)(5));
6. Certain taxes of foreign countries or US possessions (Section 702(a)(6));
7. Taxable income or loss, exclusive of the various items otherwise requiring separate computations (Section 702(a)(8); reg. section 1.702-1(a)(9)); and
8. Any other item of income, gain, loss, deduction, or credit, to the extent required by regulations (Section 702(a)(7)).

Each partner must report on its own return its distributive share of each of the separately stated items, aggregating the items with the amounts of similar items to determine if any limitations apply.

For example, individuals can generally deduct up to $3,000 of capital losses in excess of capital gains, whereas this deduction is not available to corporations. Therefore, capital gains and losses must be separately reported on page 3 of Form 1065, Schedule K, and Schedule K-1.

The partner's return retains the tax character of each of these items to the partnership. For example, a long-term capital gain realized by the partnership is a long-term capital gain on a partner's return, even if that partner has been a member of the partnership for less than a year.

There are certain classes that must be separately stated including passive activities, tax adjustment, and preference items for purposes of the alternative minimum tax computation, such as certain depreciation deductions, and deductions that partners can claim as itemized deductions, such as medical expenses. In addition, items to be taken into account separately include items related to activities not engaged in for profit.

No deductions are allowed at the LLC (partnership) level for personal exemptions, foreign taxes, net operating loss (NOL) carrybacks or carryovers, capital losses, or the deduction for depletion with respect to oil and gas wells. While a partnership may not take advantage of the NOL deduction, nor foreign taxes, the partnership can allocate percentages of the loss and foreign taxes to partners in the method described in the partnership agreement.

For purposes of determining their individual NOLs, partners may use their allocated portion of the loss to offset other income, or include it as part of an NOL that may be carried back or forward to other years on their tax returns.

There are certain limitations on the deductions for partnerships. For example, the dollar limitation on expensing Section 179 property applies to the partnership and a separate limitation applies to each individual partner. Furthermore, since a partnership is not allowed a charitable contributions deduction, each partner is considered as having paid, within the taxable year, a distributive share of any charitable contribution, payment of which was actually made by the partnership within its taxable year ending within or with the partner's taxable year.

Non-separately stated items

The non-separately stated items include income and expenses that are attributable to the businesses or trades (excluding rental activities) conducted by the partnership and have the same tax treatment for all the partners. The income and related deductions are reported on page 1 of Form 1065. The partnership's net ordinary income or loss is allocated to the partners.

Partner's distributive share

Form 1065 is designed to show separately each category of partnership income, gain, loss, deduction, or credit that could affect the computation of each partner's income tax. The partnership files Form 1065 for informational purposes only, which includes partnership activity Form K-1; the partnership's income is taxed to the partners according to their distributive shares. A partner's distributive share is reported on Schedule K-1 of Form 1065, which is provided to the partner. The partner takes the information on the Schedule K-1 and reports it on his or her tax return. Foreign partners would also be subject to US filing and reporting of K-1 activity; see Appendix D below for further discussion.

The partners, not the partnership, are liable for the tax on their allocable share of partnership income even if the income is not distributed to the partners. Furthermore, partnership income or loss is allocable to a partner only for the portion of the year that the partner is a member of the partnership.

Treatment of liabilities

To determine the treatment of liabilities (e.g., trade accounts and accrued expenses), liabilities should be distinguished between recourse and nonrecourse depending on the facts of the partnership at issue. Recourse debt is when a partner or related party shares the economic risk of loss relating to the liability or guarantees all or part of a debt; generally, the partner's basis is increased to the extent of the risk. Nonrecourse debt is when none of the partners have personal liability or bear the economic risk of loss. Since there is no risk of economic loss, the liability generally is shared by all the partners, including limited partners, in the same proportion as ownership interests.

Partnership tax elections

Most elections affecting the tax computation of partnership income and loss must be made by the partnership. Elections include the method of accounting, method of computing depreciation, and amortization of certain organization fees. Once the elections are made, they apply to all the partners.

Generally, a partnership may elect any allowable accounting method and choose an accounting method that is different from its partners unless specifically excluded. For example, the partnership can make an election to deduct and amortize organization fees, an election to amortize start-up expenditures, and an election to adjust the basis of partnership assets upon the transfer of a partnership interest or upon certain distributions from the partnership. However, if the partnership's accounting method does not clearly reflect income, the IRS has the authority to recompute partnership income under a method that the IRS deems reasonable.

Partnership taxable year

A partnership generally is required to conform to the partners' taxable years unless there is a business purpose for choosing another taxable year. Except for certain partnerships with fiscal year partners, a partnership is required to adopt a calendar year to prevent partners from deferring tax on partnership income through adopting different taxable years. A partner must include its distributive share of partnership items on its tax return in the same year as the last day of the partnership's taxable year falls.

A partnership does not have the option of selecting any taxable year (calendar or fiscal) for federal income tax purposes. A partnership must have the same taxable year as the partners who have the "majority interest taxable year," which is an aggregate interest in partnership profits of more than 50 percent on each "testing day" (defined as the first day of the partnership taxable year). The alternative is to use the taxable year of all the "principal partners" (defined as partners owning 5 percent or more of the profits or capital). If the "majority interest taxable year" or the "principal partners" cannot be determined, the partnership must adopt the calendar year unless otherwise provided by regulations.

If the taxable year of a partner is different from the partnership, the partner's share of the partnership taxable income is reported as if it were all received by the partner on the closing date of the partnership year. If the partnership has more than one closing date within a partner's taxable year, then more than one partnership period is included in the partner's return.

Taxes on corporation income

If an LLC elects to be treated as a C-Corporation, please refer to the “Stripe Atlas – PwC Corporate Guide to US Taxes” for further information.

What are the tax implications of converting from a C corporation to an LLC?

Generally speaking, a limited liability company (LLC) is a unique type of entity in that it can be classified for US federal income tax purposes differently depending on the ownership of the LLC. For example, if an LLC only has one owner it is characterized as a “disregarded entity” (i.e., it does not exist as a separate taxable entity for US federal income tax purposes, but instead its activity flows up to its owner and is taxed on the owners tax return). If the LLC has two or more owners, it is characterized as a partnership for US federal income tax purposes. With that said, an LLC is eligible to make a special election, by filing a simple form with the IRS, to be characterized as a corporation if it wanted to. Further, once it is a corporation, it has the ability to elect to be a subchapter “S” corporation (often referred to as an “S-Corp”), which has its own set of requirements and tax benefits.

When a C corporation converts to an LLC under state law, there is a tax fiction that is deemed to occur.

1. The first step in the tax fiction is a liquidation of the C corporation (will refer to this here forward as the Liquidation). The tax treatment of the Liquidation depends on a number of factors, but can either be (1) tax-free, or (2) taxable.

   In order to be tax-free, a number of requirements need to be satisfied (see the section *The Liquidation below)*. If these requirements are not met, the Liquidation will be taxable. Note that in the event the Liquidation is taxable, it is both taxable at the corporate level (i.e., taxable on the final corporate tax return, as if the entity had sold all of its assets at their fair market value) and shareholder level. This may or may not have any actual cash-tax consequence, and will ultimately depend on the tax attributes of the liquidating corporation – see the section *Impact on tax attributes* below).
2. What follows next actually depends on how the LLC will be characterized for US federal income tax purposes (based on the guidelines outlined above).
   a. To the extent the LLC is a “disregarded entity,” there is no further tax consequence of the conversion. This is because although the LLC legally holds all of the assets and liabilities, the LLC does not exist as a separate entity for US federal income tax purposes and therefore it is simply viewed as if the parent continues to hold those assets received in the Liquidation.
   b. If the LLC is characterized as a partnership, following the Liquidation it is viewed as if all assets and liabilities are then contributed to a newly formed partnership, in exchange for partnership interests. This transaction is generally tax-free.
   c. If the LLC is characterized as a C-Corp or S-Corp, there are some additional complexities that would need to be considered. If this is something you are encountering or are planning to move forward with, please consult with your tax advisors.

Tax implications of a conversion in greater detail

- Compliance:
  - General federal compliance comments:
    - **If the C corporation was part of a “consolidated group”:** When a company’s legal entity organization structure is comprised of more than one US C corporation, these entities typically join in one group tax return filing referred to as a “consolidated group” (each C corporation is referred to as a “member”). If the entity that is converting was a member of a “consolidated group” then a statement needs to be attached to the consolidated tax return for the year the conversion took place explaining that one of the members of the group liquidated (i.e., the tax result of the conversion).

- ◦ **If the C corporation was "standalone" C corporation:** If it was a "standalone" C corporation (i.e., filed its own separate US federal income tax return and was not a member of a "consolidated group"), it would file a final corporate tax return for the year of the conversion (generally, the year would end on the date of the conversion).
- - General state tax comments: Certain states do not respect disregarded LLCs and tax them as C corporations. Additionally, other states respect the flow-through nature of an LLC; however, they may require a separate tax filing even though the entity is disregarded for US federal income tax purposes. You should consult with your tax advisor regarding the state tax consequences of these types of transactions.

- The Liquidation: Generally speaking, in order to achieve a tax-free liquidation, at least the following requirements must be satisfied (not an exhaustive list): (1) the shareholder must have the requisite control (80% vote and 80% value), (2) the shareholder must receive payment with respect to each class of stock it holds, (3) the parent and subsidiary both must be corporations. If any of these requirements are not satisfied, the liquidation is taxable both to the liquidating corporation, and then to the shareholder.
- Impact on tax attributes (i.e., net operating losses (NOLs), tax credits, etc.): The impact on tax attributes will differ depending on whether or not the Liquidation is taxable or tax-free.
  - ◦ If tax-free: Generally speaking, all tax attributes carryover to the corporate shareholder. Further, the tax basis of all the assets inside the corporation also carryover (i.e., no basis step-up is achieved).
  - ◦ If taxable: If the transaction is taxable, there is a tax assessed on the final corporate tax return of the liquidating entity, as if it sold all of its assets to the shareholder at their fair market value. This is a complicated transaction and calculation and therefore you should consult your tax advisor.
- Outside basis: When a C corporation is formed, typically the owners contribute cash and or operating assets to it, so the business can run, and in exchange the C corporate issues shares to the owners/contributors of the cash and operating assets. Generally speaking, this contribution is tax free. As such, the shares that the owners hold have a basis equal to the basis they had in the assets they contributed – this basis is referred to as "outside basis." The C corporation now holds these assets and operates the business. The corporation also has a basis in these assets – this is referred to as "inside basis" as it's the basis "inside the corporation." Over time the assets are depreciated for US federal income tax purposes, and the inside basis decreases. As a result, the outside basis is typically higher than inside basis. In any liquidation, whether taxable or nontaxable, the outside stock basis in the liquidating entity is eliminated/lost. To the extent outside basis exceeds inside basis, consider the inside vs outside tax basis. For example:
  - - Assume the business is worth $100, the outside basis the shareholders had in the stock was $90 and the inside basis the corporation had in the assets it held was $80.
    - ◦ If the shareholders sold the stock of the C corporation, gain of $10 would be recognized.
    - ◦ If the C corporation was converted to an LLC, and the members sold the member units (the equity), gain of $20 would be recognized.

Note that if the C corporation was acquired in a taxable transaction (and no special tax election was made), the discrepancy between inside and outside basis can be large as the shareholders have an outside basis equal to the purchase price, but the corporation's inside basis in the assets remains un-changed (is not stepped up to the fair market value/purchase price paid).

- Consult with a tax advisor before converting an acquired C corporation to an LLC.
- Consult with a tax advisor before converting a C corporation with a built-in loss (i.e., the shareholders outside basis is greater than the fair market value of the C corporation stock) to an LLC.

- Go-forward taxation: Converting from a C corporation to an LLC generally eliminates the double taxation that a C corporation is subject to. However, to the extent the LLC is held by a C corporation, no benefit is achieved as the income flows from the LLC up to the C corporation parent, subject to tax at the corporate level. In order for double taxation to be avoided, the LLC would need to be a disregarded entity held by an individual or a flow-through entity; however, under this fact pattern it would not be possible to obtain a tax-free liquidation. Generally speaking, when exiting the corporate solution (and double taxation) there will be a final tax assessed on any built-in gain of assets inside that liquidating corporation.
- Self-employment taxes: an LLC member that is an individual is liable for the full amount of self-employment taxes on any guaranteed payments, plus its share of any pass through ordinary income.

Guaranteed payments are those made by a partnership to a partner (member) that are determined without regard to the partnership's income. A partnership treats guaranteed payments for services, or for the use of capital, as if they were made to a person who is not a partner. Specifically guaranteed payments that are compensation for services actually rendered to the partnership are self-employment earnings, and therefore subject to self-employment taxes. In addition to income taxes, the IRS requires you to pay self-employment taxes on guaranteed payments and all partnership profits allocated to you. Self-employment taxes consist of contributions to the Social Security and Medicare systems, similar to what employees must pay. Thus, future federal tax liabilities may increase.

What are the tax implications of converting from an LLC to a C corporation?

To the extent the LLC is a “disregarded entity” and it converts to an entity that is treated as a C corporation for US federal income tax purposes, such transaction is generally expected to be viewed as a tax free incorporation, by the members of the LLC, of the assets in the LLC. This generally holds true if (1) the liabilities of the LLC do not exceed the tax basis in its assets, and (2) the LLC members only receive back shares (membership interest) of the newly formed C corporation. Other unique fact patterns could require additional considerations; thus, converting from an LLC to a C corporation should be discussed with a tax advisor.

Other Federal Taxes

1. Sales & Use Taxes

The US does not impose a federal sales tax, use tax, or value-added tax (VAT). For information related to sales and use taxes that are imposed by the States, please refer to Section II. State and Local Tax Issues.

2. Customs duties and import tariffs

All goods imported into the United States are subject to customs entry and are dutiable or duty-free in accordance with their classification. The classification also identifies eligibility for special programs and free-trade agreement preferential duty rates.

When goods are dutiable, ad valorem, specific, or compound duty rates may be assessed. An ad valorem rate, the type most often applied, is a percentage of the value of the merchandise. A specific rate is a specified amount per unit of measure (weight or quantity). A compound rate is a combination of both an ad valorem rate and a specific rate. US Customs and Border Protection (CBP) requires that the value of the goods be properly declared regardless of the dutiable status of the merchandise.

Payment of duty becomes due at the time an entry is filed with CBP. The obligation for payment is on the person or firm in whose name the entry is filed, the importer of record. The importer of record has a legal obligation to exercise reasonable care in all aspects of its importing activity.

3. Excise taxes

The US government imposes excise taxes on a wide range of goods and activities, including gasoline and diesel fuel used for transportation, air travel, manufacturing of specified goods, and indoor tanning services.

The excise tax rates are as varied as the goods and activities on which they are levied.

Payroll Taxes

All payments for employment within the United States are wages subject to

1. Federal income tax withholding,
2. Federal Insurance Contributions Act (FICA) taxes (i.e., social security and Medicare), and
3. Federal Unemployment (FUTA) tax, which are withheld by the employer on behalf of the employee. Exceptions may apply. For employees sent to the United States by their foreign employer, there is a *de minimis* exception for amounts less than $3,000 and visits of less than 90 days; also, certain treaty provisions may eliminate the need to withhold income taxes (but generally not the need to report).

If a company has US employees, it must pay and withhold social security taxes equal to 6.2% of wages for the employer and 6.2% for the employee, up to $128,400 of wages in 2018, and Medicare taxes equal to 1.45% for the employer and 1.45% for the employee. There is no cap on wages subject to Medicare taxes. The employer also must withhold an additional 0.9-percent Medicare tax on wages above $200,000. The FUTA tax is between 0.6 and 6.0% (depending on credits for state unemployment taxes) on the first $7,000 of wages paid to an employee.

A company generally must file quarterly and annual employment tax returns and annual wage statements (Forms W-2) in its name and employer identification number unless such statements are filed by a properly authorized third party.

Transfer pricing

Transfer pricing regulations govern how related entities set internal prices for the transfers of goods, intangible assets, services, and loans in both domestic and international contexts. The regulations are designed to prevent tax avoidance among related entities and place a controlled taxpayer on par with an uncontrolled taxpayer by requiring inter-company prices to meet the arm's-length standard.

The arm's-length standard is met if the results of a related party transaction are consistent with results that would have been realized if unrelated taxpayers had engaged in a similar transaction under similar circumstances. Under the regulations, it is often the case that the arm's length result can be determined to fall within a range of comparable transactions or comparable profits. Comparable for a given transaction are determined considering the following variables:

- Nature of the goods or services being provided
- Relationship between the parties and function of the transaction between the parties
- Contract terms
- Economic conditions such as geographic markets

If a company is not in compliance with the arm's-length standard, the IRS may adjust taxable income and tax payable in the United States. For additional information on global tax issues, including additional transfer pricing guidance, please see Appendices E and F.

Determining income

1. Gross Receipts

Income received in the normal course of business will be treated as ordinary and taxable income, eligible to be offset by various tax deductions, as discussed below.

2. Capital Gains

Gains or losses on the sale or exchange of capital assets held for more than 12 months are treated as long-term capital gains or losses. Gains or losses on the sale or exchange of capital assets held for 12 months or less are treated as short-term capital gains or losses. The excess of net long-term capital gain over net short-term capital loss is considered net capital gain.

For LLCs, generally capital losses are allowed only as an offset to capital gains. Net capital losses and net capital gains are reported as separately stated items and taxed based on the member's tax profile for partnerships and sole proprietorship. For Corporations, capital gains are simply added to the corporation's ordinary income along with other income items and taxed at the corporate tax rates.

a. LLC: Partnership Taxation

LLCs that choose to be taxed as a partnership will default to not recognize any profits or losses but pass them through to each partner (member) based on the partner's ownership percentage. The net capital gain or loss is reported on Schedule K of Form 1065, US Return of Partnership Income. Each partner will receive a K-1 showing the amount of capital gain to include as part of income or loss that can be deducted on their tax return. The partner takes the information on the Schedule K-1 and reports it on their applicable entity tax return. Foreign partners would also be subject to US filing and reporting of K-1 activity; see Appendix D below for further discussion.

b. LLC: C Corporation Taxation

LLCs that elect to be taxed as a C corporation are subject to dual taxation. If capital gains exceed capital losses, the net gain is considered ordinary income and added to the LLC's other income. If capital losses exceed capital gains, the amount is carried back to the previous three years. Any remaining capital losses can be carried forward for up to five years. The LLC pays taxes on capital gains at the corporate rate. Profits are paid out in dividends, and the LLC members will pay taxes on the dividends at their tax rates. Please refer to the "Stripe Atlas – PwC Corporate Guide to US Taxes" for further information.

c. LLC Disregarded Entity Taxation

An LLC with only one member is treated as an entity disregarded and not separate from its owner for federal income tax purposes (but as a separate entity for purposes of employment tax and certain other taxes). If the single member LLC's owner is an individual, the IRS treats the business as a sole proprietorship for income tax purposes. LLC owners therefore report business income and losses on their personal tax returns.

Deductions

1. Depreciation and amortization

Depreciation deductions are allowances that may be taken for capital expenditures for tangible property. These deductions generally flow thru to the LLC members.

2. Charitable contributions

Charitable deductions flow thru to the members and are generally limited based on the member's taxable income (with the exception of C Corporations). Deductions for contributions that are limited may be carried over to future years, subject to certain limitations.

3. Research or experimental expenditures

Depending on entity classification, research or experimental (R&E) expenditures that are paid or incurred during the tax year are generally deductible and flow thru to members. Taxpayers also can make a special election to amortize their research expenditures over 120 months.

4. Other common business expenses deductible for tax

- Salaries and Wages
- Repairs and Maintenance Expenses
- Bad debts
- State, local, and other taxes (excluding federal income tax)
- Advertising and marketing
- Interest expense. Limitations exist on the amount of interest expense deductible, specifically as it relates to payments made to foreign related

5. Other significant items

- No deduction generally is allowed for a contingent liability until such liability is fixed and determinable
- Costs incurred for entertainment must meet strict tests to be deductible
- Royalty payments, circulation costs, mine exploration, and development costs, and other miscellaneous costs of carrying on a business are deductible, subject to certain conditions and limits.

Credits and incentives

1. Foreign tax credit (FTC)

Generally, in any year, a US company or individual can choose whether to take as a credit (subject to limitation) or as a deduction foreign income and excess profit taxes paid or accrued during the tax year to any foreign country or US possession. An FTC reduces US income tax liability dollar for dollar, while a deduction reduces US income tax liability at the marginal rate of the taxpayer.

2. General business credit

Various business credits are available to provide special incentives for the achievement of certain economic objectives. In general, these credits are combined into one 'general business credit' for purposes of determining each credit's allowance limitation for the tax year. The general business credit that may be used for a tax year is limited to a tax-based amount. In general, the current year's credit that cannot be used in a given year because of the credit's allowance limitation may be carried back to the tax year preceding the current year and carried forward to each of the 20 years *following the current year.*

Administrative issues

1. Reporting and Withholding

Withholding payments are generally required to be made by the LLC's or its members. If the payment falls into the categories noted below, requiring a withholding, the payor withholds the tax from the payment, which is then reported to the recipient on the appropriate form. Withholding payments are remitted to the IRS on various forms depending on the member's entity status; please consult your tax advisor.

a. 1099-K

Form 1099-K is an IRS information return used to report certain payment transactions to improve voluntary tax compliance. If you have received payments from card transactions (e.g., credit or stored-value cards), or payments in settlement of third party network transactions, you will receive Form 1099-K by January 31st of the following year from your payment service provider.

You must report all income received on your tax return for all income you receive, you will need the information from Form 1099- K when computing your federal income taxes. Note that certain states also require 1099 reporting and have different activity thresholds for required reporting. Please consult with your tax professional for more information.

b. Reporting payments to US people or companies

A US entity engaged in a trade or business that during the calendar year makes payments to a US non-exempt payee totaling $600 or more must report the amount of the payments on Form 1099-MISC, *Miscellaneous Income*. Payments subject to Form 1099-MISC reporting include compensation for services (other than wages paid to employees), rents, royalties, commissions, gains, and certain types of interest. US payers are responsible for reporting the payment whether made by cash, check, or wire transfer. Amounts paid by payment card (including debt, credit, and procurement) are not subject to Form 1099-MISC reporting by the payor.

Form 1099-MISC must be furnished to payees no later than January 31 of the year subsequent to the year of payment and must be filed with the IRS by February 28 of the year following the payment. Requests to extend these dates may be made, but extensions are not automatic.

The payor also must file Form 945, *Annual Return of Withheld Federal Income Tax*, to report any backup withholding. Form 945 must be filed with the IRS by January 31 of the year succeeding the year of payments.

c. Withholding on payments to non- US people and non-US companies

If your new LLC makes certain payments to entities or individuals outside of the US, you must consider withholding requirements in the US.

People and companies making US-source payments ('withholding agents'), such as US-source interest, dividends, and royalties, to foreign people or foreign companies generally must withhold 30% of the payment amount as tax withheld at source. In other situations, withholding agents may apply a lower rate of withholding if the payee is eligible for a reduced rate under a tax treaty or by operation of the US tax laws (e.g., portfolio interest exemption).

The ability to apply a reduced rate depends on whether the withholding agent receives valid documentation evidencing the foreign payee's eligibility for a lower rate of withholding. Valid documentation includes documentation provided using Form W-8. Since there are various Forms W-8, the payee must determine which one is the correct form to be completed.

d. Withholding on payments to US people and US companies

All US and non-US entities are responsible for information reporting and backup withholding for payments made to US non-exempt recipients. Backup withholding at the current rate of 24% is required if the US non-exempt recipient fails to provide a taxpayer identification number (TIN) in the proper manner prior to payment or if the payor is instructed to backup withholding by the IRS.

Payments made to US exempt recipients are not subject to reporting or backup withholding and such recipients are not required to provide a TIN. Exempt recipients include governments (federal, state, and local), tax-exempt organizations under IRC Section 501(a), individual retirement plans, international organizations, foreign central banks of issue, and most corporations and financial institutions.

Payments made to US non-exempt recipients for dividends, gross proceeds, interest, compensation for services, rents, royalties, prizes, awards, and litigation awards, among others, must be reported. A proper TIN should be obtained from all US payees to avoid backup withholding. A TIN is best obtained by receiving a valid Form W-9, *Request for Taxpayer Identification Number and Certificate,* from US payees, including exempt recipients. The IRS's TIN Matching Program also can be utilized to help to establish names or TINs with IRS records to help to establish accuracy.

e. *Reporting payments to non-US people and non-US companies*

Any taxes withheld on payments made to foreign payees must be reported to the IRS on Form *1042, Annual Withholding* Tax Return for US Source Income of Foreign Persons. A foreign person is a person who is not a citizen of the host country in which he or she is residing or temporarily residing. For example, a foreign national in Canada is someone who is neither a Canadian citizen nor a permanent resident of Canada. Form 1042 must be filed with the IRS on or before March 15 following the calendar year in which the income subject to reporting was paid, unless an extension of time to file is obtained. Form 1042 must be filed if a Form 1042-S is filed (see below), even if there is no withholding on the payment. A withholding agent must file with the IRS and furnish to each foreign payee Form 1042-S, Foreign Person's US Source Income Subject to Withholding. Form 1042-S is the information return used by withholding agents to report US-source payments paid to foreign payees. Form 1042-S must be filed with the IRS and furnished to the foreign payee on or before March 15 following the calendar year in which the income subject to reporting was paid, unless an extension is obtained. Form 1042-S is required whether or not withholding on the payments has occurred.

f. *FATCA*

FATCA, the Foreign Account Tax Compliance Act, was enacted in 2010 to prevent and detect offshore tax evasion. FATCA requires many foreign financial institutions (FFIs) and some nonfinancial foreign entities (NFFEs) to enter into agreements with the IRS under which they undertake procedures to identify which of their accounts are held by US people or US companies and annually report information regarding such accounts to the IRS.

FATCA imposes registration, due diligence reviews, information reporting, and tax withholding obligations on entities that qualify as foreign financial institutions (FFIs). Legal entities with FFI characteristics must determine whether they are, in fact, FFIs and, if so, whether they are required to register with the IRS. For example, taxpayers with an interest in, or signature or other authority over, foreign financial accounts whose aggregate value exceeded $10,000 at any time annually generally must file "Foreign Bank Account Report" (FBAR); this refers to FinCen Form 114, Report of Foreign Bank and Financial Accounts. The FBAR is a calendar year report and must be filed on or before April 15 of the year following the calendar year being reported. Effective July 1, 2013, the FBAR must be filed electronically through FinCEN's BSA E-Filing System. The FBAR is not filed with a federal tax return.

Businesses that do not adhere to the new obligations under FATCA may face a variety of consequences.

g. *Other Informational Forms*

As part of the federal income tax return, you may be required to submit other informational forms. For example, Form 5472 is required for foreign owned US companies and is used to report certain transactions that occur between foreign and US companies that are related.

2. *Filing requirements*

a. *Tax period*

US LLCs are required to report income tax filings on an annual basis. The LLC may choose a tax year that is different from the calendar year (refer to details above).

b. *Tax returns*

The US tax system is based on the principle of self-assessment. A multimember LLC must file an annual tax return (Form 1065) by the 15th day of the third month following the close of its tax year. Taxpayers can obtain a six-month extension to file its tax return, provided it timely and properly files Form 7004 and deposits the full amount of any tax due. Failure to timely file may result in interest and penalties. Taxpayers who elect to be taxed as a C-corporation, please refer to the filing requirements in "Stripe Atlas – PwC Corporate Guide to US Taxes". The IRS treats one-member LLCs owned by individuals as sole proprietorships for tax purposes.

This means that the LLC itself does not pay taxes and does not have to file a return with the IRS. As the sole owner of your LLC, you must report all profits (or losses) of the LLC on Schedule C and submit it with your 1040 or 1040NR tax return, due by the 15th day of the fourth month following the close of the calendar year (or by the 15th day of the tenth month following the close of the calendar year if the return is on extension).

c. *Payment of tax*

A taxpayer's (members) tax liability generally must be prepaid throughout the year in four equal estimated payments and fully paid by the date the tax return is initially due for that year. For calendar-year corporations and individuals, the four estimated payments are due by the 15th days of April, June, September, and December (the 15th of January of the following year for individuals). For fiscal-year corporations, the four estimated payments are due by the 15th days of the fourth, sixth, ninth, and twelfth month of the tax year (individuals do not have fiscal years). Generally, no extensions to pay are allowed. Failure to pay the tax by the due dates can result in estimated tax and late payment penalties and interest charges.

3. *Statute of limitations*

The IRS generally has three years after an original return is filed to assess income taxes. A return will be deemed to have been filed on its extended due date, even if the return is actually filed on an earlier date.

4. *Tax accounting methods*

For US federal tax purposes, the two most important characteristics of a tax method of accounting are timing and consistency. If the method does not affect the timing for including items of income or claiming deductions, it is not an accounting method and generally, IRS approval is not needed to change it. In order to affect timing, the accounting method must determine the year in which an income or expense item is to be reported.

In general, in order to establish an accounting method, the method must be consistently applied, which typically means two years of consistent filing. Once an accounting method has been adopted for federal tax purposes, any change must be requested by the taxpayer and approved by the IRS. Changes in accounting methods cannot be made through amending returns. The two most common methods of accounting are the accrual-basis and cash-basis methods.

5. *Penalties*

Civil and criminal penalties may be imposed for failing to follow the Internal Revenue Code when paying US taxes. The civil penalty provisions may be divided into four categories: delinquency penalties, accuracy-related penalties, information reporting penalties, and preparer, promoter, and protester penalties. Many, but not all, of these provisions, include exceptions for reasonable cause should reasonable cause exist. In addition, many include rules as to how a particular penalty interacts with the other penalties. Failure to file the 1065 Partnership Tax Return means that the IRS will charge a late filing penalty. The late filing penalty for a 1065 Partnership Tax Return is $195 dollars per partner (K-1) and month. The IRS defines a month as "any part of a month".

State and local tax issues

Companies with activity in the United States often are surprised that such activity may trigger both federal and state-level taxes. Even more surprising, there are no uniform rules among the states as to whether state tax liability attaches; in some cases, significant state tax liabilities may be imposed even if little or no US federal tax obligations exist.

Activities that could subject an entity to state tax

A state generally may impose its tax on an entity to the extent a sufficient 'nexus' or taxable connection exists between the entity and the state. While US federal taxation generally requires a threshold level of activity of being 'engaged in a trade or business' or having a 'permanent establishment,' mere physical presence in a state, such as having employees, owning property, storing inventory, or paying for rental property in the state, generally may be sufficient for nexus to exist for state taxation purposes. We also note physical presence is not necessarily a requirement to have nexus with a state; for example, on June 21, 2018, the US Supreme Court in *South Dakota v. Wayfair* overturned prior Court decisions and ruled that a physical presence is not required for the imposition of sales and use tax. This decision will have far-ranging tax and accounting impacts on companies, including LLC's. Therefore as a business owner/member, it is important to be aware of the constant changes, and account for them to reduce your potential risk.

If you are a resident of one state and earned non-resident income in another, you generally need to report this income on your resident state tax return. You are required to pay tax on all income received, even if it is from other states. You also might have a filing and tax requirement in the nonresident state; however you will likely be eligible to receive a credit on your resident state taxes. In those cases, you could have a tax liability in multiple states.

Once again, there is no clear cut answer if you need to file – it depends. Practically speaking, you may not owe any taxes, but some states require returns even if you owe no tax. It's important to know the requirements of each state.

Economic nexus could be deemed to exist between a state and a company based on the presence of intangible property in a state. For example, the license of trademarks to a company located in a state could create nexus for the out-of-state licensor on the basis that the intangibles are 'present' in the state.

We note that property tax is also a state tax that individuals and businesses could be subject to. For purposes of this Guide, we have not included discussion on this tax other than to point out it exists and to consult your tax advisor for further advice.

Allocating taxable income among the states: multistate apportionment

For US state tax purposes, a percentage of the entire net income of an entity may be subject to tax by a state. That percentage generally relates to the proportionate level of activity (e.g., sales, property, and payroll) the entity has within the state as compared with its activity outside the state.

Indirect tax considerations

State 'indirect taxation' generally refers to any state tax that is not based on income. The most common indirect tax is a state's sales and use tax; other indirect taxes include franchise taxes, real estate transfer taxes, telecommunications taxes, commercial rent taxes, and hotel occupancy taxes. The indirect taxes that apply depend on the nature of the company's business activities.

Once a company has nexus to a state with respect to sales and use taxes, that company must register with the state's tax department, file sales tax returns, and pay its sales tax liabilities. Depending on the volume of sales, the company may be required to file returns on an annual, quarterly, or monthly basis. Generally, sales tax is imposed on retail sales, leases, rentals, barters, or exchanges of tangible personal property and certain enumerated services unless specifically exempted or excluded from tax.

Sales tax generally is imposed in the jurisdiction in which the 'sale' occurs. The definition of 'sale' differs from jurisdiction to jurisdiction; however, the definition generally includes both consideration and transfer of title, right to use, or control (possession) in the case of tangible property and completion of the service act in the case of a service.

Local taxation

Many cities impose separate income tax filing obligations. Compliance complexities multiply as US taxation geographies can be further divided within states and some US cities have significant taxing powers.

In addition, cities impose local-level sales and use taxes. Administratively, the sales taxes usually are collected by and remitted to the state, and then allocated to the localities. Generally, the rules for the localities are modeled after the rules for the states, but this is not always the case. The rules can vary from jurisdiction to jurisdiction. Overall, there are thousands of indirect taxing jurisdictions in the United States.

Delaware Franchise Tax

LLC's have the following requirements:

- Any entity that is formed in Delaware (regardless of where you conduct business) must pay an Annual Tax for the privilege of incorporating in Delaware of $300.
- Annual Taxes are due no later than June 1st of each year.
- There is no requirement to file an Annual Report or pay Franchise Tax.
- Failure to pay the required annual taxes will result in a $200 penalty plus 1.5% interest per month.

LLCs who have elected to be treated as C-Corporations have a required Annual Report filing fee of $50 due March 1. Starting in 2018, the minimum tax is $175 for corporations using the Authorized Shares method and $400 for corporations using the Assumed Par Value Capital Method. Maximum Tax is $200,000 for both methods unless it has been identified as a Large Corporate Filer, then their tax will be $250,000. Please refer to the "Stripe Atlas – PwC Corporate Guide to US Taxes" for further information.

Delaware requires that businesses with nexus in the state must be licensed to do business in the state and pay a fee, the amount of which varies depending upon the type of business. Additionally, such businesses are generally required to pay a gross receipts tax. The gross receipts tax is imposed on a business's gross receipts in Delaware. When determining the gross receipts tax due, most businesses are entitled to an exclusion, which varies depending on the business activity conducted. Generally the gross receipts tax applies only to gross receipts for Delaware sales, however businesses need to keep documentation of the out of state sales.

US tax treaties

The United States has in place income tax treaties with more than 60 countries, including treaties with most European countries and other major trading partners, including Mexico, Canada, Japan, China, Australia, and the former Soviet Union countries. Under these treaties, residents (not necessarily citizens) of foreign countries are taxed at a reduced rate, or are exempt from US taxes on certain items of income they receive from sources within the United States. For state considerations, please see other state tax issues within this Guide.

There are many 'gaps' in the US tax treaty network, particularly in Africa, Asia, the Middle East, and South America.

US income tax treaties typically cover various categories of income, including:

- Business profits
- Passive income, such as dividends, interest, and royalties
- Income earned by teachers, trainees, artists, athletes, etc.
- Gains from the sale of personal property
- Real property income
- Employment income
- Shipping and air transport income
- Income not otherwise expressly mentioned

The categories of income covered vary from treaty to treaty, and no two treaties are the same.

To gain treaty benefits, it is necessary to satisfy the conditions of the residency article as well as certain other requirements.

How can PwC help?

As can be seen from the discussion above, the complexity of US tax law has a profound effect on foreign-owned US operations as well as US-owned operations, and, most importantly, the return on investment. These complexities provide incentive to manage efficiently the US businesses. In our experience with US activities, we are seeing increased activity from the tax authorities in the areas of jurisdiction to tax, income shifting, inbound financing, repatriation, and withholding.

PwC's Tax practice comprises a national network of cross-disciplinary professionals dedicated to understanding the unique nuances faced by both domestic and foreign-based Multi-National Corporations (MNCs). We provide technical support and end-to-end view of issues to assist companies in formulating their US policies. We have identified, developed, implemented, and documented a wide variety of opportunities strategies to help foreign MNCs meet their business needs.

In the current challenging economic environment, we can work together on:

- **Acquisitions and dispositions:** Evaluate the US tax implications of US inbound acquisitions and dispositions designed to implement key initiatives
- **Business and tax alignment:** Align cross-border business and tax objectives
- **Compliance:** Address compliance requirements with respect to US federal and state tax laws, particularly targeted areas such as transfer pricing and FACTA
- **US income tax treaties and competent authority:** Determine the applicability and desirability of obtaining the benefits of US tax treaties in the context of cross- border financing and investment, as well as international mergers, acquisitions, and dispositions
- **US tax benefits:** Consider federal and state tax benefits, including credits and incentives available to US inbound companies
- **Legislative and regulatory services:** Monitor real-time developments on fast-moving US federal and state legislative and regulatory developments and their impact on business planning
- **Audit support:** Respond to IRS and state revenue agency challenges, including proper characterization of US inbound financings as debt versus equity.

Appendix A: Other taxes

1. Stamp taxes

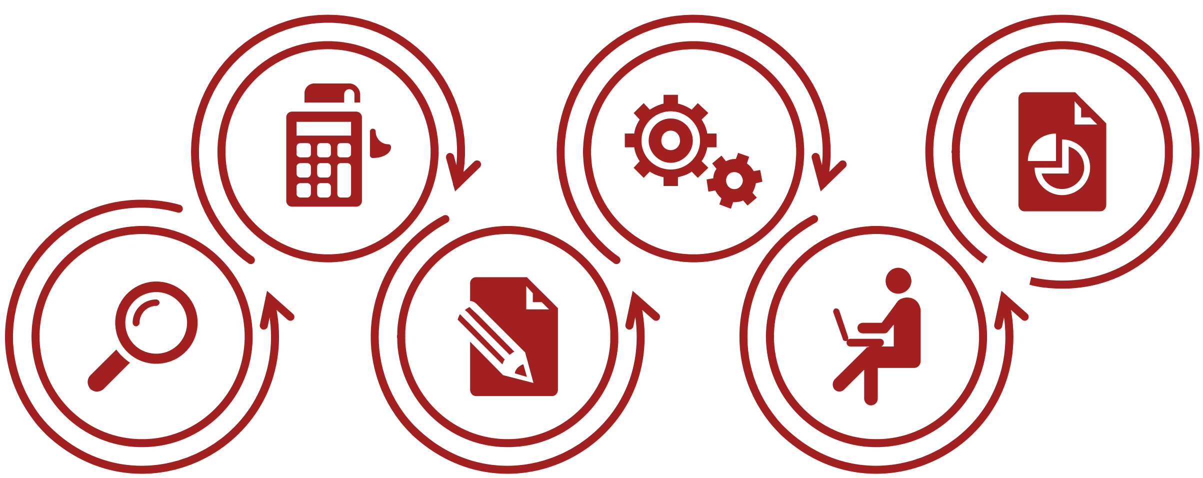
There is no federal-level stamp tax. However, state and local governments frequently impose stamp taxes at the time of officially recording a real estate or other transaction. The state or local sales tax on real estate may be a stamp tax on the documents recording the transfer of the real estate.

2. Capital gain

The corporate tax rate on long-term capital gains depends on the member's status. For members that are corporations, it is taxed at the same rate as ordinary income. Thus, the maximum corporate rate is 21%, excluding the additional phase-out rates. However, if the member is an individual it will be taxed between 10-23.8%.

3. Affordable Health Care Act (ACA)

The Affordable Care Act contains comprehensive health insurance reforms and includes tax provisions that affect individuals, families, businesses, insurers, tax-exempt organizations and government entities. These tax provisions contain important changes, including how individuals and families file their taxes.



Appendix B: Other issues

1. Group taxation

A partnership may not be included in a consolidated return, even if it is 100% owned by members of an affiliated group, since a partnership is not a corporation. However, a member's earnings that flow through from a partnership are included as part of the consolidated group's taxable income or loss. Filing on a consolidated (combined) basis is also allowed (or may be required or prohibited) in certain states.

2. Thin capitalization

Thin capitalization rules may apply to disallow interest payments related to 'excess' debt and to recharacterize such payments as dividends. One of the tax law changes enacted in 2017 imposes a new limitation on deductions for business interest expense. The limitation is earnings-based and is imposed by section 163(j) of the Tax Code. For most taxpayers, deduction of net business interest expense is limited to 30 percent of their adjusted taxable income for tax years beginning after Dec. 31, 2017. For more information on section 163(j), please consult your tax advisor.

3. Payments to foreign affiliates

A US limited liability company generally may claim a deduction for royalties, management service fees, and interest charges paid to foreign affiliates, to the extent the amounts are actually paid and are not in excess of what it would pay an unrelated entity (i.e., are at arm's length). US withholding on these payments may be required.

Appendix C: Information reporting

Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding*, is the most commonly used Form W-8. That version is used to establish that the payee is not a US person and is the beneficial owner of the income related to which the Form W-8BEN is being provided. Form W-8BEN also can be used to claim a reduced rate of withholding based upon an applicable income tax treaty. **Note:** Form W-8BEN is used only by individuals. Entities use Form W-8BEN-E.

Form W-8BEN-E, *Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)*. Among other purposes (e.g., FATCA), this form is used to establish that the payee is not a US person and is the beneficial owner of the income related to which the Form W-8BEN-E is being provided. Form W-8BEN-E also can be used to claim a reduced rate of withholding based upon an applicable income tax treaty. **Note:** Form W-8BEN-E is used only by entities. Individuals use Form W-8BEN.

In addition to Form W-8BEN or Form W-8BEN-E, other forms that can be provided by a foreign payee to reduce or eliminate withholding are:

- Form W-8ECI, *Certificate of Foreign Person's Claim That Income Is Effectively Connected with the Conduct of a Trade or Business in the United States*, is provided by a non-US entity or individual that is engaged in a US trade or business and has income that is effectively connected with such US trade or business.
- Form W-8EXP, *Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding & Reporting*, is provided by non-US governments or non-US tax-exempt organizations.
- Form W-8IMY, *Certificate of Foreign Intermediary, Foreign Flow Through Entity, or Certain US Branches for United States Tax Withholding & Reporting*, is provided by a non-US flow-through entity (e.g., partnership) that is not engaged in a US trade or business. Form W-8IMY generally must be accompanied by Forms W-8 and/or Form W-9 for the beneficial owners and a withholding statement that allocates the income to the beneficial owners.

Treaty claims made by nonresident alien individuals who provide independent personal services in the US are made on Form 8233, *Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual*, instead of on Form W-8BEN.

Forms W-8BEN, W-8BEN-E, W-8ECI, and W-8EXP generally are valid for three years from the date the form is signed. New forms are required prior to the expiration of three years if there is a change in the information disclosed by the payee on the forms. For some purposes (not applicable if treaty benefits are claimed), the forms can remain valid indefinitely absent a change in circumstances. Form W-8IMY is valid indefinitely unless there is a change in the information disclosed by the payee on the forms. Form 8233 is valid for only one year. Once the Company has collected W-8BEN, the Company should retain copies on file in case requested by the IRS.

Appendix D: Foreign company and individual considerations

When foreign limited liability companies are investing in the US they should be aware of the potential US tax implications for the foreign entity interacting with the US. While the US tax consequences of the US limited liability company are described throughout this Guide, there are other tax considerations for a foreign company to manage the US tax risk of the activities of the foreign company. The following issues should be considered:

US trade or business

Generally, a foreign owned limited liability company engaged in a US trade or business is taxed at regular US tax rates. The LLC is taxed on income from US sources that is effectively connected with that business; if the LLC has income on US-source income that it is not effectively connected with, the withholding rate is 30 percent imposed on that gross income, unless lowered by treaty. A non-resident who earns income that is effectively connected with a U.S. trade or business (other than personal service income, e.g., wages) is subject to the same estimated tax payment requirements as residents.

There is no definition in the tax statute of a trade or business within the United States—instead, that concept has been developed mainly by the IRS and court decisions through a facts-and-circumstances analysis. The following have been considered by the courts and/or the IRS:

- The business must have a profit motive.
- Activities generally must be ‘considerable, continuous, and regular.’
- Ministerial, clerical, or collection-related activities generally are not sufficiently profit-oriented to constitute a US trade or business.
- Isolated activities generally do not rise to the level of a trade or business.
- An agent’s activities in the United States may result in a US trade or business.

Is the foreign partner engaged in a US trade or business?

Generally, when a foreign person engages in a trade or business in the United States, all income from sources within the United States connected with the conduct of that trade or business is considered to be Effectively Connected Income (ECI). This applies whether or not there is any connection between the income, and the trade or business being carried on in the United States, during the tax year. A foreign person is defined by the IRS to include: an individual who is not a citizen or resident of the United States, an individual who is a citizen or resident of a US possession who is not otherwise a citizen or resident of the United States, any partnership, association, company, or corporation that is not created or organized in the United States.

You are considered to be engaged in a trade or business in the United States if you are temporarily present in the United States as a nonimmigrant on an "F," "J," "M," or "Q" visa. The taxable part of any US source scholarship or fellowship grant received by a nonimmigrant in "F," "J," "M," or "Q" status is treated as effectively connected with a trade or business in the United States.

If you are a member of a partnership that at any time during the tax year is engaged in a trade or business in the United States, you are considered to be engaged in a trade or business in the United States.

You usually are engaged in a US trade or business when you perform personal services in the United States.

If you own and operate a business in the United States selling services, products, or merchandise, you are, with certain exceptions, engaged in a trade or business in the United States. For example, profit from the sale in the United States of inventory property purchased either in this country or in a foreign country is effectively connected trade or business income.

Gains and losses from the sale or exchange of US real property interests (whether or not they are capital assets) are taxed as if you are engaged in a trade or business in the United States. You must treat the gain or loss as effectively connected with that trade or business.

Income from the rental of real property may be treated as ECI if the taxpayer elects to do so.

Under Section 875(1), if a partnership is engaged in a US trade or business (USTB) then each of its foreign partners is deemed to be so engaged. This rule applies without regard to the number of ownership tiers interposed between the foreign partner and the operating partnership. This entity-oriented approach, therefore, sweeps into the domestic taxing net a foreign partner regardless of the extent of their ownership or degree of participation in the partnership.

Reg. Sec. 1.875-1 provides that the same test for determining whether an individual is engaged in a USTB applies for determining whether a partnership is engaged in a USTB. Activities of the partnership that do not rise to the level of a trade or business should not be attributed to a partner who is a foreign person for purposes of determining whether such person is engaged in a USTB.

The Code itself does not provide a general definition of the phrase “trade or business within the United States.” In general, whether a partnership is engaged in a USTB is determined through a factual analysis of the activities that transpire at the partnership level. The courts generally have required that the activities in the United States be considerable, continuous, and regular to give rise to a USTB. Pinchot v. Comm'r., 113 F.2d 718 (2d Cir. 1940) (a foreign person holding substantial real estate in the United States was engaged in a US business where its agent's management activities were considerable, continuous, and regular); Linen Thread Co. v. Comm'r., 4 T.C. 802 (1945) (collecting income from investments and sporadic sales was not the conduct of a business in the United States). Because the existence of a business in the United States is considered a factual issue, the IRS will not issue advance rulings with respect to particular transactions. (Rev. Proc. 85-22, 1985-1 C.B. 550)

Foreign-owned single-member LLCs

The regulations treat a US domestic, disregarded entity wholly owned by a foreign person as a domestic corporation separate from its owner for the limited purposes of reporting, record maintenance and associated compliance requirements. A foreign person includes:

- An individual who is not a citizen or income tax resident of the United States;
- Any partnership, association, company or corporation that is not created or organized in the United States; and
- A trust that is classified as foreign under either the control test or the court test in Section 7701(a)(31) of the Internal Revenue Code.

The following US LLCs, among others, may be required to file Form 5472

- An LLC with a single non-US owner, which may be a foreign individual, company, partnership or non-grantor trust;
- An LLC owned by another LLC which is owned by a single non-US owner, in which case both LLCs may have a filing requirement;
- An LLC owned by a grantor trust (whether domestic or foreign), the grantor of which is foreign; and
- An LLC owned by a non-US company that has made an election to be disregarded for US income tax purposes and is owned by a single non-US individual, company, partnership or trust.

A single-member LLC owned by a foreign person is also generally required to report LLC income, deductions and credits on Schedule C of their individual US tax return (Form 1040NR) due by the 15th day of the fourth month following the close of the calendar year (or by the 15th day of the tenth month following the close of the calendar year if the return is on extension).

Foreign-owned multi-member LLCs

If the multi-member LLC has not made an election to be taxed as a C-Corporation, it is classified as a partnership for US income tax purposes. An LLC treated as a partnership is required to file Form 1065 (US Return of Partnership Income) annually with the IRS, unless the LLC neither receives income nor incurs any expenditures treated as deductions or credits for federal income tax purposes.

Effectively connected income

As mentioned above, passive-type income and gain from the sale of capital assets are treated as effectively connected to the US trade or business and subject to US tax if a connection with the US trade or business exists.

Certain types of foreign-source income generated through a US office can be effectively connected income. These include:

- Rents or royalties for use of property located outside the United States
- Foreign-source dividends or interest derived in active conduct of banking business in the United States, or received by a corporation the principal business of which is trading in stocks or securities for its own account
- Gain from the sale outside the United States of inventory property and property held for sale to customers, unless the property is sold for use outside the United States and a non-US office materially participates in the sale.

Determining if a foreign partner's income is effectively connected income

The first issue in determining if a foreign partner's income is effectively connected income is to determine whether the foreign partner is engaged in a USTB. If the foreign partner is considered engaged in a USTB, it next must determine whether the foreign partner's income or its distributive share of partnership income is considered effectively connected to a USTB.

Permanent Establishment (PE)

Multinational businesses face a variety of tax systems in the countries where they operate. To reduce or eliminate double taxation between countries, promote cross-border trading, and alleviate the burden of administration and enforcement of tax laws, countries typically enter into income tax treaties outlining how parties to the treaty (contracting states) will be taxed on income earned in each contracting state.

Income tax treaties contain an article describing whether the activities of an enterprise rise to a level of a permanent establishment (PE) in a contracting state. The existence of a PE is important because it gives the contracting state the right to tax the enterprise's income attributable to the PE. This includes income from carrying on a business in the contracting state and passive income, such as interest, dividends, and royalties.

A PE generally means:

- There is a fixed place of business through which the business of an enterprise is wholly or partly carried on, or
- An agent acting on behalf of the enterprise has and habitually exercises the authority to conclude contracts binding on the enterprise.

U.S. source FDAP income and capital gains

If a foreign partner is considered engaged in a USTB, its US source of Fixed, Determinable, Annual or Periodic income (FDAP) and capital gains are effectively connected only to the extent such income either (1) is derived from assets used or held for use in the taxpayer's trade or business (so-called "asset-use test") or (2) the activities of the taxpayer's trade or business were a material factor in the production of the income (so-called "material factor test"). (Section 864(c)(2); Reg. Sec. 1.864-4(c)) In addition, the regulations contain special rules for determining whether US source FDAP income and capital gains are income that is effectively connected in the case of a foreign person engaged with the "active conduct of a banking, finance or similar business in the United States." (See Reg. Sec. 1.864-4(c)(5).)

US source other than FDAP and capital gains

All US source income of a foreign taxpayer other than FDAP or capital gain income is treated as effectively connected to the taxpayer's trade or business under Section

864(c)(3). This limited "force-of attraction" principle brings within the US tax system not only ordinary business profits generated by the taxpayer's US business, but also US source profits from sales that are unrelated to the taxpayer's USTB.

In general, a foreign partner engaged in a trade or business activity in the United States will be taxable on "business profits" generated from that activity under a bilateral tax treaty only to the extent the foreign person has a "PE" in the United States to which the profits are "attributable." Thus, the sometimes harsh results of the limited "force-of attraction" principle may be avoided under a bilateral tax treaty where the unrelated income would be exempt from US tax since it generally would not be "attributable" to the taxpayer's PE in the United States.

Foreign source income

If a foreign partner is considered engaged in a USTB, in certain narrow situations, foreign source income may be treated as effectively connected income of a foreign taxpayer. Section 864(c)(4) provides that, in general, certain categories of foreign source income will be treated as effectively connected if the taxpayer has an office or fixed place of business in the United States to which such income is attributable. The purpose behind this rule is to tax income that has its true economic source in the United States, but which the taxpayer has been able to convert to foreign source income by virtue of manipulation of the Code's source rules.

Section 864(c)(5) provides detailed rules for determining when a foreign person is deemed to have an office or fixed place of business and when income is deemed to be attributable to such office or fixed place of business.

The office or fixed place of business of a partnership is considered to be the office or fixed place of business of each of its partners.

Section 864(c) also characterizes as effectively connected certain items of income or gain that would have been treated as effectively connected if the transaction giving rise to the income or gain had occurred in an earlier year when the taxpayer was engaged in a USTB. In effect, these rules carry forward the taxpayer's trade or business status to the year in which the income or gain is recognized.

Withholding of foreign partner's share of effectively connected income

If a partnership has "effectively connected taxable income," Section 1446(a) requires withholding with respect to any portion of such income that is allocable to a foreign partner under Section 704. The applicable withholding rate is the highest rate of tax imposed by the Code on the type of partner involved. Each foreign partner may credit the partner's share of the Section 1446 withholding tax paid by the partnership against the foreign partner's federal income tax liability.

Branch profits tax

The US imposes an additional tax (a 30 percent "branch profits tax") on the branch income of a foreign corporation for income derived in the United States. This tax rate is reduced if the dividends taxation rate is less under an applicable bilateral US income tax treaty. This branch profits tax is a substitute tax for what would be a tax on a profits distribution (i.e., dividend) if the branch had been incorporated as a domestic corporation.

If a foreign corporation has effectively connected income then, in addition to the normal corporate income tax imposed on the foreign corporation's net effectively connected income, the foreign corporation is subject to a 30 percent tax (which rate may be reduced, eliminated, or prohibited by treaty) on its "dividend equivalent amount." (Section 884(a)) Thus, foreign corporations may bear effective US tax on effectively connected income at a combined rate of 54.5 percent, computed without regard to state and local taxes.

The branch profits tax is imposed on the taxpayer's effectively connected earnings and profits, adjusted for increases and decreases in the taxpayer's US net equity. The regulations specifically address how these concepts are applied.

If an LLC elects to be treated as a C-Corporation, please refer to the "Stripe Atlas – PwC Corporate Guide to US Taxes" for further information.

Appendix E: Transfer pricing

Due to growing government deficits, many jurisdictions are putting additional pressure on transfer pricing in order to secure a larger portion of entities' profits for their tax bases.

This can result in the risk of tax assessments, double taxation of the same income by two jurisdictions, and penalties for failure to properly allocate income among two or more jurisdictions. Therefore, virtually all large MNCs require consideration of international transfer pricing strategies and potential risks.

Transfer pricing applies to a wide range of intercompany transactions, including transactions involving:

- Tangible goods (e.g., manufacturing, distribution)
- Services (e.g., management services, sales support, contract R&D services)
- Financing (e.g., intercompany loans, accounts receivable, guarantees, debt capacity)
- Intangible property (e.g., licenses, royalties, cost sharing transactions, platform contribution transactions, sales of intangibles).

The international standard for determining the appropriate transfer price is the arm's-length principle.

Under this principle, transactions between two related parties should not produce results that differ from those that would have resulted from similar transactions between independent companies under similar circumstances. This principle is cited in the US transfer pricing rules (IRC Section 482 and the Treasury regulations thereunder), the OECD Transfer Pricing Guidelines, and the UN Manual for developing countries. There are some countries (e.g., Brazil) that do not follow the international application of the arm's- length principle.

If a transaction between related parties is priced differently than if it were between unrelated parties, the IRS has authority to reallocate income or expenses to reflect the amounts that would have resulted had the transaction been conducted at arm's length.

The Section 482 regulations are extensive and attempt to address a full range of transactions in light of the arm's-length standard. In practice, however, it is not easy to determine the appropriate arm's-length result based on a given set of facts and circumstances. Transactions of goods and services may embody unique, company or industry- specific elements that are difficult to compare with transactions involving other companies. The Section 482 regulations concede the rarity of identical transactions, and instead, attempt to determine the arm's-length results based on the 'best method' rule.

Best method rule

The Section 482 regulations provide several specified methods to test whether a price meets the arm's-length standard. Although there is no strict priority of methods, and no method invariably will be considered to be more reliable than another, every transaction reviewed under Section 482 must be judged under the method that, under the facts and circumstances, provides the most reliable measure of an arm's- length result (i.e., the 'best method').

The selection of a method also varies depending on the type of transaction. For example, the regulations provide five specified methods for transactions involving tangible property, six specified methods for service transactions, three for transactions involving intangible property, and five for platform contribution transactions as part of a cost sharing arrangement. Methods not specified in the regulations are also potentially applicable. Note that while each method is important to understand, an examination of each is beyond the scope of this discussion.

Comparability factors

To determine the best method for a particular transaction, the relative reliability of a method must be evaluated on the degree of comparability between the controlled transaction or taxpayers and uncontrolled comparables, taking into account certain factors. While a specific comparability factor may be of particular importance in applying a method, each method requires an analysis of all the factors that affect comparability under that method.

Quality of data and assumptions

Whether a method provides the most reliable measure of an arm's-length result also depends upon the reliability of the assumptions and the sensitivity of the results to possible deficiencies in the data and assumptions.

The completeness and accuracy of the data affect the ability to identify and quantify those factors that would affect the result under any particular method. Likewise, the reliability of the results derived from a method depends on the soundness of assumptions made in applying the method. Finally, the sensitivity of results to deficiencies in data and assumptions may have a greater effect on some methods than others. In particular, the reliability of some methods depends heavily on the similarity of property or services involved in the controlled and uncontrolled transaction, while other methods rely on broad comparisons of profitability.

Arm's-length range

The Section 482 regulations recognize that a method is likely to produce a range of arm's length results and provide that a taxpayer will not be subject to adjustment if the taxpayer's results fall within such an arm's- length range. The arm's-length range ordinarily is determined by applying a single pricing method selected under the best method rule to two or more uncontrolled transactions of similar comparability and reliability.

The comparables used for the uncontrolled transactions must be sufficiently similar to the controlled transaction. If material differences exist between the two transactions, adjustments must be made in order for the uncontrolled transaction to have a similar level of comparability and reliability. In many cases, the reliability of the analysis will be improved by adjusting the range through the application of a valid statistical method, often the interquartile range of results.

Penalties and documentation

The Internal Revenue Code imposes penalties if a taxpayer receives an IRS transfer pricing adjustment exceeding certain thresholds. The penalties do not apply, however, if the taxpayer has prepared and documented a reasonable transfer pricing analysis supporting its reported transfer pricing.

Under Section 6662(e), the transfer pricing penalty generally is equal to 20% of the underpayment of tax attributable to the transfer pricing misstatement, but increases to 40% of the underpayment of tax for larger adjustments.

Having contemporaneous transfer pricing documentation that satisfies the requirements under Section 6662(e) in place at the time the tax return is filed can provide protection against these penalties.

Another avenue for avoiding potential transfer pricing penalties can be an advance pricing agreement (APA)—an agreement between a government and a taxpayer that provides prospective 'certainty' for a defined term regarding covered intercompany transactions. APAs can be unilateral (between the taxpayer and the IRS), bilateral (with the IRS and another tax authority), or multilateral (with the IRS and more than one other tax authority).

In the future, other approaches for avoiding adjustments or penalties for certain controlled transactions without the need for documentation or APAs may become available. For example, the United States is considering providing safe harbors for certain types of routine transactions, such as distribution functions of inbound companies. The US view on this approach is similar to that outlined by the OECD. However, the United States intends to implement any such policy in a bilateral fashion that would require reaching a separate agreement with each treaty partner. As a result, it likely will take some time before safe harbors become a component of US tax policy.

www.pwc.com

To schedule a discussion with a PwC professional on general US tax issues, please contact pwc@stripe.com