

Guide to U.S. Taxes presented by PwC

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pwc

Table of contents

<i>Executive Summary</i>	3
<i>A guide to the key US tax issues</i>	
<i>Federal tax issues</i>	9
<i>State and local tax issues</i>	15
<i>US Tax Treaties</i>	17
<i>How can PwC help?</i>	18
<i>Appendix A: Other Taxes</i>	19
<i>Appendix B: Other Issues</i>	20
<i>Appendix C: Information reporting</i>	21
<i>Appendix D: Foreign company considerations</i>	22
<i>Appendix E: Transfer pricing</i>	24
<i>Appendix F: The OECD's BEPS project</i>	26



Federal Income Tax

Who is subject to US Income Tax?



All US corporations must file an annual federal corporate tax return.

What do I need to file?

Form 1120, the annual corporate tax return, is used to determine your taxable income and federal tax liability. In addition to the 1120, there are other informational forms that may be required. For example, Form 5472, is required to be filed by a foreign owned, US company.



[Link to Form 1120](#)

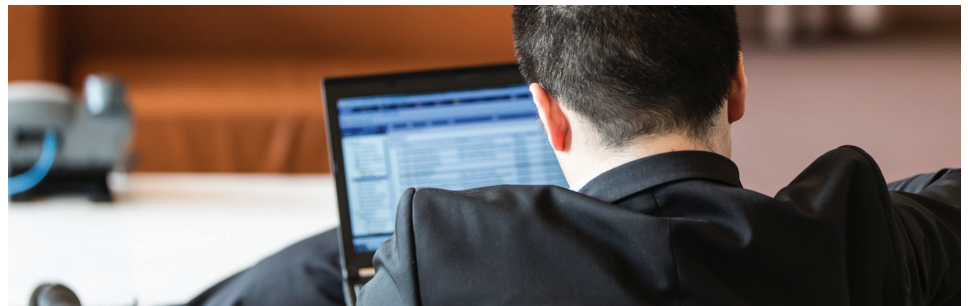
How much tax will I owe?

Your US corporation will be taxed at a standard rate on their taxable income. US taxable income is based on your gross receipts less various business expenses (e.g., cost of goods sold, salaries and wages). Your taxable income is subject to increasingly higher tax rates ranging from 15% to 39% depending on the amount of taxable income.



How can my taxes be reduced?

Numerous credits to reduce tax are available, including credits for certain research activities. If a company generates taxable losses in one year, the losses can be carried back two years and forward twenty years to offset taxable income in those years.



2016 taxable income		US corporate income tax		
Over (\$)	But not over (\$)	Pay (\$)	+% on excess	Of the amount over (\$)
0	50,000	0	15	0
50,000	75,000	7,500	25	50,000
75,000	100,000	13,750	34	75,000
100,000	335,000	22,250	39	100,000
335,000	10,000,000	113,900	34	335,000
10,000,000	15,000,000	3,400,000	35	10,000,000
15,000,000	18,333,333	5,150,000	38	15,000,000
18,333,333			35	0

When do I have to file my taxes?

A corporate taxpayer must file their 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 timely and properly files Form 7004, and pays the full amount of any tax due by the original due date. For example, if a corporate taxpayer whose year end is December 31, 2016 properly obtains an extension, its 2016 federal tax return that would normally be due on **March 15, 2017** is extended to be due on **September 15, 2017**.



When are tax payments due?

All of your federal income taxes are due by the 15th day of the third month following the close of the tax year, regardless of an extension granted for filing the actual return. Following your first tax year in the US, you may be required to make estimated tax payments at the close of each quarter. Companies expecting a taxable profit for the year should consider whether or not estimated taxes are owed, and how much is required to be paid in the year.



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 IRS, 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 10%.



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).



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. 44 US states impose a corporate income tax, and a company can be subject to income tax in as many states as they have nexus. Each state has their own criteria for nexus but, in general, owning property, paying for rental property, 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.



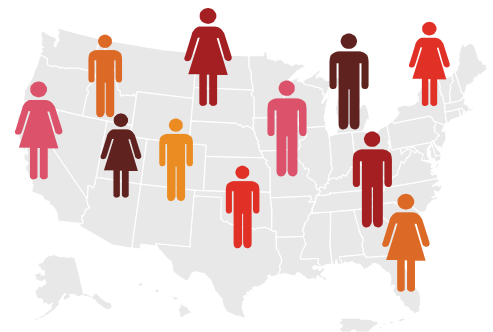
When are state taxes due?

Most states require the corporate 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 timely and properly files the extension form for that jurisdiction and deposits the full amount of any tax. Similar to federal income taxes, most require tax paying corporations to submit estimated taxes on a quarterly basis.



Other state tax issues

A handful of states impose a franchise or gross receipts tax in addition to or in place of an income tax, reported on their annual tax returns. There may be situations where you are not required to pay an income tax, but may still be subject to a filing requirement and payment of a franchise, capital, or gross receipts tax. These taxes are a way for states to tax you based on your gross receipts, or balance sheet capital rather than taxable income.



Transfer Pricing

Transfer pricing regulations govern how related entities set prices for the transfers of goods, intangible assets, services, and loans. The US looks to what is known as the arm's-length standard to determine the appropriate price.

If you have multiple entities within your structure that interact with each other, transfer pricing may be applicable to you. If multiple related parties within the US have transactions, there may also be state transfer pricing issues to consider.

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 parties had engaged in a similar transaction under similar circumstances. Analyzing comparables in your industry is important for appropriate transfer pricing and tax compliance.

The IRS may adjust your profits and taxes you owe, as well as impose penalties for incorrect transfer pricing. Having your transfer pricing positions accurately documented can help you avoid penalties.

Examples of Transfer Pricing considerations:

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

- Is the amount charged by the foreign parent the same amount that they would have charged to an unrelated third party?
- If IRS determines the purchase price was not at 'arm's length' then an adjustment will be required on the purchase price

Foreign parent licenses software to be used by the US subsidiary

- What rate does the foreign parent charge the US subsidiary for use of 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.



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

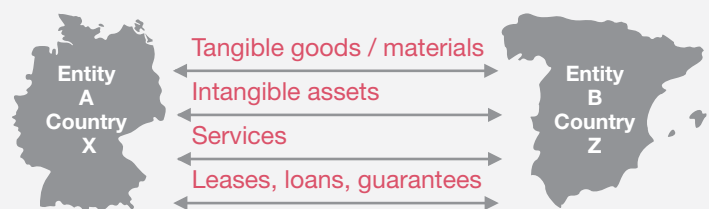
- Does the US Subsidiary charge the foreign parent for the services they are providing?
- If so, is the rate being charge appropriate under the 'arm's length' standard?
- If the neither are considered, the IRS may consider an adjustment and impute income in the US for the services being provided, and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

US subsidiary uses the name brand of the foreign parent

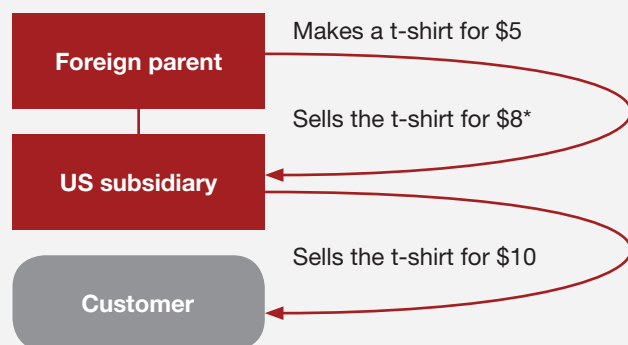
- What royalty payment does the foreign parent charge the US subsidiary for use of the brand name?
- If the IRS determines the rate being charged is too high, when considering the 'arm's length' standard, the deduction taken in the US may be adjusted

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

Indirect Taxes

- There is no federal value added tax (“VAT”) or 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 taxes.



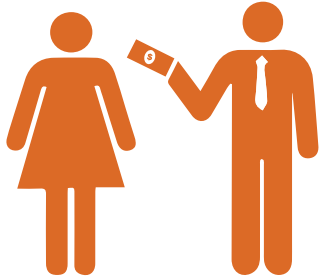
Sales & Use Taxes

- Generally, 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, barter, 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

- Any corporation that is incorporated in Delaware (regardless of where you conduct business) must file an Annual Franchise Tax Report and pay Franchise Tax for the privilege of incorporating in Delaware.
- Franchise Taxes and annual Reports are due no later than March 1st of each year.
- The Delaware Franchise Tax will range from \$175 to \$180,000 depending on the amount of the company's authorized shares. For example, a corporation having 10,000 authorized shares will have a tax of \$250. Generally, the more shares the US corporation has, the higher the Franchise Tax (with a maximum annual tax of \$180,000). An Annual Report filing fee of \$50 is also required.



Withholding Taxes

- People and companies making payments such as interest, dividends, and royalties, to foreign people or foreign companies generally must withhold 30% of the payment amount as tax withheld at source.
- A lower rate of withholding can apply if the payee is eligible for a reduced rate under a tax treaty or by operation of the US tax laws. The ability to apply a reduced rate requires valid documentation evidencing the foreign payee's eligibility for a lower rate of withholding. For further details on applicable tax treaties, please refer to the Addendum.
- Any taxes withheld on payments made to foreign payees must be reported to the IRS before March 15 following the calendar year in which the income subject to reporting was paid. An extension of time to file can also be obtained.



Payroll Taxes

- A payroll tax obligation will exist for a US company 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 \$118,500 of wages in 2015, and Medicare taxes equal to 1.45% for the employer and 1.45% for the employee.
- 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.



Further guidance

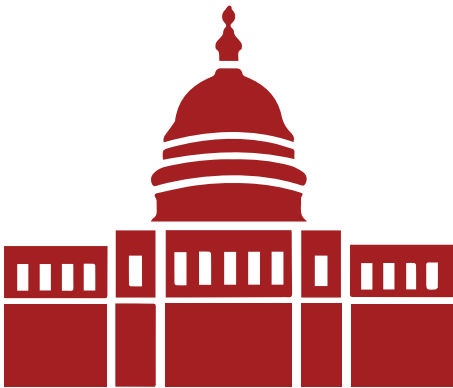
For a more comprehensive discussion of US Taxation, please see the following section, “A guide to the key US tax issues.”

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 2016

Federal tax issues



Taxes on corporate income

1. Corporate income tax

All US corporations are subject to federal income taxes. US corporations are taxed based on their worldwide income. Generally, US taxable income is based on your gross receipts less various business expenses (e.g., cost of goods sold, salaries and wages).

The US corporate income tax rate is based on a progressive rate schedule; however, an alternative minimum tax applicable to some corporations provides for a flat rate with fewer deductions.

2016 taxable income		US corporate income tax		
Over (\$)	But not over (\$)	Pay (\$)	+% on excess	Of the amount over (\$)
0	50,000	0	15	0
50,000	75,000	7,500	25	50,000
75,000	100,000	13,750	34	75,000
100,000	335,000	22,250	39	100,000
335,000	10,000,000	113,900	34	335,000
10,000,000	15,000,000	3,400,000	35	10,000,000
15,000,000	18,333,333	5,150,000	38	15,000,000
18,333,333			35	0

2. Alternative minimum tax (AMT)

The corporate alternative minimum tax (AMT) is a separate, parallel US tax system that was enacted to ensure that corporations do not avoid their fair share of tax by utilizing certain provisions in the tax law.

As a separate parallel tax structure, taxable income for AMT is computed differently as compared to normal taxable income. For example, if you have certain items such as accelerated depreciation, percentage depletion, or non-taxable income, AMT may apply because these items are treated differently when computing AMT taxable income.

An AMT is imposed on corporations other than small corporations (generally those not having three-year average annual gross receipts exceeding \$7.5 million). The tax is 20% of alternative minimum taxable income (AMTI) in excess of a \$40,000 exemption amount (subject to a phase-out). AMTI is computed by adjusting the corporation's regular taxable income by specified adjustments and 'tax preference' items.

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.

For further information regarding customs, [click here](#).

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) the 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 \$118,500 of wages in 2015, 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, the arm's length range will be based on comparables. Comparables 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 corporations, capital losses are allowed only as an offset to capital gains. An excess of capital losses over capital gains in a tax year may be carried back three years and carried forward five years to be used against (offset) capital gains.

3. Other Income

Other common forms of income include interest, rent, and royalties. Please see page 1 of Form 1120, lines 1-10 for a list of general sources of revenue included in taxable income. ([Form 1120](#))

Corporate deductions

1. Depreciation and amortization

Depreciation deductions are allowances that may be taken for capital expenditures for tangible property.

Additionally, corporations can elect to expense, up to a statutory amount per year, the cost of certain eligible property used in the active conduct of a trade or business, subject to a taxable income limitation and to a phase-out of the deduction.

2. Charitable contributions

Deductions for allowable charitable contributions may not exceed 10% of a corporation's taxable income computed without regard to certain deductions, including charitable contributions themselves. Deductions for contributions so limited may be carried over to the five succeeding years, subject to the 10% limitation annually.

3. Research or experimental expenditures

Corporations can elect to expense all research or experimental (R&E) expenditures that are paid or incurred during the tax year or to defer the expenses for 60 months. 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

See Form 1120, page 1 lines 12-26 for the common deductions available to offset revenue and arrive at taxable income. ([Form 1120](#))

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.

6. Net operating losses (NOLs)

An NOL is generated when business deductions exceed gross income in a particular tax year. An NOL may be carried back to offset past income and possibly obtain a refund or carried forward to offset future income. Generally, a loss may be carried back two years and, if not fully used, carried forward 20 years.

Credits and incentives

1. Foreign tax credit (FTC)

Generally, in any year, a US company 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.

3. Research credit

The research tax credit is available for companies that make qualified research expenditures to develop new

or improved products, manufacturing processes, or software in the United States. The credit is available with respect to qualified research expenses (QREs) incurred.

Qualified small businesses have the opportunity to claim a portion of their research credit against their employer FICA tax liability (as previously described in the Payroll section), rather than against their income tax liability.

Administrative issues

1. Reporting and Withholding

Withholding payments are required to be made by the corporation making the payments. 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.

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.

As you must report on your income tax return all income you receive, you will need the information from Form 1099-K when computing your income taxes.

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 maybe 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 US company 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 28% 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 withhold 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 verify names or TINs with IRS records to ensure 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*. 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.

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

The FATCA compliance requirements can be complex depending on your situation. [Click here](#) to learn more about FATCA

g. Other Informational Forms

As part of your 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 corporate taxpayers are taxed on an annual basis. Corporate taxpayers may choose a tax year that is different from the calendar year. New corporations may use a short tax year for their first tax period, and corporations changing tax years also may use a short tax year.

b. Tax returns

The US tax system is based on the principle of self-assessment. A corporate taxpayer must file an annual tax return (generally Form 1120) 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 timely and properly files Form 7004 and deposits the full amount of any tax due. Failure to timely file may result in penalties.

c. Payment of tax

A taxpayer's 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, the four estimated payments are due by the 15th days of April, June, September, and December. For fiscal-year corporations, the four estimated payments are due by the 15th days of the fourth, sixth, ninth, and 12th month of the tax year. 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 due date, even if the return is actually filed on an earlier date.

4. Accounting for income taxes

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. 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 in not complying. In addition, many include rules as to how a particular penalty interacts with the other penalties.

State and local tax issues

Foreign 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.

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.

Dividing up 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, barter, 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.

Local taxation

Many cities impose separate income tax filing obligations. Compliance complexities multiply because US taxation geographies are 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

Any corporation that is incorporated in Delaware (regardless of where you conduct business) must file an Annual Franchise Tax Report and pay Franchise Tax for the privilege of incorporating in Delaware. Franchise Taxes and annual Reports are due no later than March 1st of each year.

The Delaware Franchise Tax will range from \$175 to \$180,000 depending on the amount of the company’s authorized shares. A corporation having 5,000 authorized shares or less is considered a minimum stock corporation with a tax of \$175.

Generally, the more shares the US corporation has, the higher the Franchise Tax (with a maximum annual tax of \$180,000). An Annual Report filing fee of \$50 is also required.

Corporations having nexus in Delaware are also required to file corporate income tax returns. However, corporations that maintain a statutory corporate office in Delaware but that do not do business in Delaware and corporations whose activities in Delaware are limited to the maintenance and management of intangible investments are exempt from corporate income tax.

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 business are generally required to pay a gross receipts tax. The gross receipts tax is imposed on a business’s gross receipts in Delaware.

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. 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 and, importantly, the return on investment. These complexities, coupled with the comparatively high US corporate income tax rate, provide incentive to manage efficiently US businesses while ensuring that effective tax rate remains competitive. In our experience with US inbound 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 US Inbound Tax practice comprises a national network of cross-disciplinary professionals dedicated to understanding the unique nuances faced by foreign-based MNCs. We provide technical support and end-to-end view of issues to assist MNCs in formulating their US inbound policies. We have identified, developed, implemented, and documented a wide variety of strategies to help foreign MNCs meet their business needs while maintaining a competitive effective tax rate.

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.

Our approach is designed to identify tax opportunities and help manage efficiently adverse tax outcomes, so that the US business of a foreign MNC plays its part in implementing a globally effective and integrated approach to tax planning for the group and so that desired tax outcomes are integrated seamlessly into business objectives and operations.

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 taxes

The corporate tax rate on long-term capital gains currently is the same as the tax rates applicable to a corporation's ordinary income. Thus, the maximum corporate rate is 35%, excluding the additional phase-out rates. However, differences may arise where AMT is imposed.

3. Accumulated earnings tax

The accumulated earnings tax equals 15% of 'accumulated taxable income.' Generally, accumulated taxable income is the excess of taxable income with certain adjustments, including a deduction for regular income taxes, over the dividends paid deduction and the accumulated earnings credit. Note that a corporation can justify the accumulation of income, and avoid tax, based on its reasonable business needs.

4. Personal holding company tax

The personal holding company tax, which is levied in addition to the regular tax, is 20% of undistributed personal holding company income. A personal holding company is a C corporation with more than 50 percent of the value of its outstanding stock owned by five or fewer individuals and which receives at least 60 percent of its adjusted ordinary gross income from passive sources.

Appendix B: Other Issues

1. Group taxation

An affiliated group of US ‘includible’ corporations, consisting of a parent and subsidiaries directly or indirectly 80% owned, generally may offset the profits of one affiliate against the losses of another affiliate within the group by electing to file a consolidated federal income tax return.

Filing on a consolidated (combined) basis is also allowed (or may be required or prohibited) under the tax laws of certain states.

Sales, dividends, and other transactions between corporations that are members of the same group generally are deferred or eliminated until such time as a transaction occurs with a non-member of the group. Losses incurred on the sale of members of the group are disallowed under certain circumstances.

2. Thin capitalization

Thin capitalization rules may apply to disallow interest payments related to ‘excess’ debt and to recharacterize such payments as dividends. In addition, the taxpayer’s interest expense deduction can be limited and suspended if more than 50% of the adjusted taxable income of a corporation (with similar rules for a corporate partner in a partnership) is sheltered by interest paid to a related party (or paid to a third party but guaranteed by the related party) that is not subject to US tax on the income.

3. Payments to foreign affiliates

A US corporation 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.

Appendix D: Foreign company considerations

When foreign individuals or corporations 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 corporation 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 corporation engaged in a US trade or business is taxed at regular US corporate tax rates on income from US sources that is effectively connected with that business and at 30% on US-source income not effectively connected with that business.

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.



Effectively connected income

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.

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 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.



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 in 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 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, while only three are specified for transactions involving intangible property. 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.

Appendix F: The OECD's BEPS project

OECD BEPS Action Plan

Since 2012, G20 countries and the OECD have pursued an initiative to reform international tax regimes by addressing opportunities for base erosion and profit shifting. A 15-point BEPS 'Action Plan' was issued in July 2013, and the OECD final reports have been issued.

The US is a member of the OECD and can be expected to continue to adopt rules which are consistent with the direction of much of the OECD final reports into the Federal tax rules. This is also true at the state and local level. As a result, an investor into the US must watch developments here closely as the rules will be evolving over the next few years. Furthermore, companies should also monitor developments in their home countries, as the timing for potential updates may be sooner as compared to the US.

A consistent theme of the OECD BEPS initiative is that international tax rules have not kept pace with an increasingly globalized economy. Policymakers have expressed concern about a perceived lack of clarity over the line between acceptable tax planning and aggressive tax avoidance. In

response, they have proposed greater transparency regarding companies' tax affairs, with the goal of increasing the pressure on multinational enterprises (MNEs) to pay a 'fair share' of tax in the countries where they operate.

For example, under new 'country-by-country' reporting requirements, MNEs would have to disclose to tax authorities detailed information for their business globally and in each country where they have a presence. There may be an increasing need to explain clearly to tax authorities the operational purpose of business arrangements that include tax advantages. In this environment, companies no longer can focus solely on technical compliance with tax rules, but instead need to be prepared to provide explanations in situations where profit allocations seem to diverge from the location of employees, tangible assets, and sales.

Increased risk of double taxation

Historically, the goal of the OECD has been to promote global economic growth and development through the unfettered exchange of goods and services, and the movement of capital, technology, and persons across

borders. To that end, the OECD's focus has been on eliminating impediments to cross-border flows, such as double taxation, by expanding income tax treaty networks, by establishing clear rules for governments with respect to taxing companies with a limited presence in their jurisdictions, and by reducing gross basis withholding taxes.

The OECD BEPS project, by contrast, has been focused on eliminating so-called 'double non-taxation.' In this quest, the OECD also has sought to coordinate action among participating governments in order to avoid increasing the risk of unrelieved double taxation. It is unclear, however, whether the OECD will succeed in its coordination efforts. As a consequence, there are serious concerns that one outcome of the BEPS project could be a dramatic surge in instances of double taxation and tax disputes worldwide.

Departing from consensus-building OECD model

The rapid pace of the BEPS project, with discussion drafts being released and finalized quickly (sometimes with less than 30 days allowed for public comments) conflicts with the traditional approach of OECD

consensus building. True consensus around a single solution chosen from an array of options can be difficult to achieve under such short deadlines. The difficulty of harmonizing the divergent views of source and residence countries, and of the developed OECD economies and the developing non-OECD G20 economies, has proven challenging.

Instead of setting forth a consensus on key issues, the OECD in several reports has presented a ‘menu’ of options to address base erosion concerns, in order to meet prescribed deadlines. For example, access to treaties likely will become more uncertain for MNEs, as competing subjective general anti-avoidance rules and main-purpose tests are proposed to prevent treaty shopping. Also of concern, proposals intended to prevent ‘artificial avoidance’ of permanent establishment (PE) status consist primarily of options for lowering the PE threshold.

Moving away from arm’s-length transfer pricing standards

As tax authorities’ concerns grow with separate-entity accounting and the ability of MNEs to transfer functions, assets, and risks across borders, international tax policy may be at risk of moving away from traditional arm’s-length transfer pricing models to a more formulaic allocation of income and deductions, similar to models used by many US state governments. The experience of US states should stand as a warning, because historically states have had difficulty achieving consensus

on formulas for allocating income and deductions across jurisdictions, with double taxation possible as a result of non-uniform formulas.

Dispute resolution difficulties

Strains in resolving cross-border tax disputes—evident even before the BEPS Action Plan was initiated and reflected in the annual OECD report on mutual agreement procedure (MAP) statistics—are likely to increase as the BEPS project moves forward. The inventory of MAP cases around the world has risen steadily, with OECD statistics for 2013 reflecting a 12.1 percent increase in the number of open MAP cases as compared to the 2012 reporting period, and a 94.1 percent increase as compared to 2006 (although MAP cases involving two OECD member countries are double counted in that total).

Potential uncoordinated, unilateral actions by some countries, spurred by the BEPS project, combined with increasing information available to tax authorities, suggest that MAP statistics could worsen in coming years, unless improved dispute resolution procedures are implemented.

The ‘gold standard’ for dispute resolution procedures has been mandatory, binding, ‘baseball-style’ arbitration, which has been remarkably successful in resolving cross-border tax controversies governed by US tax treaties. In this type of arbitration, each party in a dispute submits a proposal, and an arbitrator chooses

one of the proposed settlement offers without modification. In response to opposition from some countries that have characterized binding arbitration as an infringement on their sovereignty, the initial OECD discussion draft on improving dispute resolution mechanisms does not include a recommendation for use of baseball-style arbitration as a tool to resolve issues that are preventing agreement in a MAP case.

Increased risk of unilateral actions

Questions have been raised as to whether the BEPS project is encouraging some countries to take unilateral actions in advance of the project’s completion. Rather than waiting for the BEPS process to play out and consensus rules to emerge, some governments are using the BEPS project to advance their domestic tax agendas and to claim their ‘fair share’ of corporate tax revenues.

The risk inherent in this trend is that as soon as one country moves ahead of the OECD consensus process, others are spurred to action, not wanting to be left behind. For example, the recent action by the United Kingdom to propose a ‘diverted profits tax’ may encourage other countries to propose similar policies affecting companies operating in their jurisdictions. As a result, the danger of ‘global tax chaos marked by the massive re-emergence of double taxation,’ of which the OECD Action Plan itself warned, may have markedly increased.

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

Joseph Olson

Tax Partner

971 544 4311

joseph.d.olson@pwc.com

Joel Walters

US Inbound Tax Leader

646 471 7881

joel.walters@pwc.com

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