US Inbound Taxation Brochure

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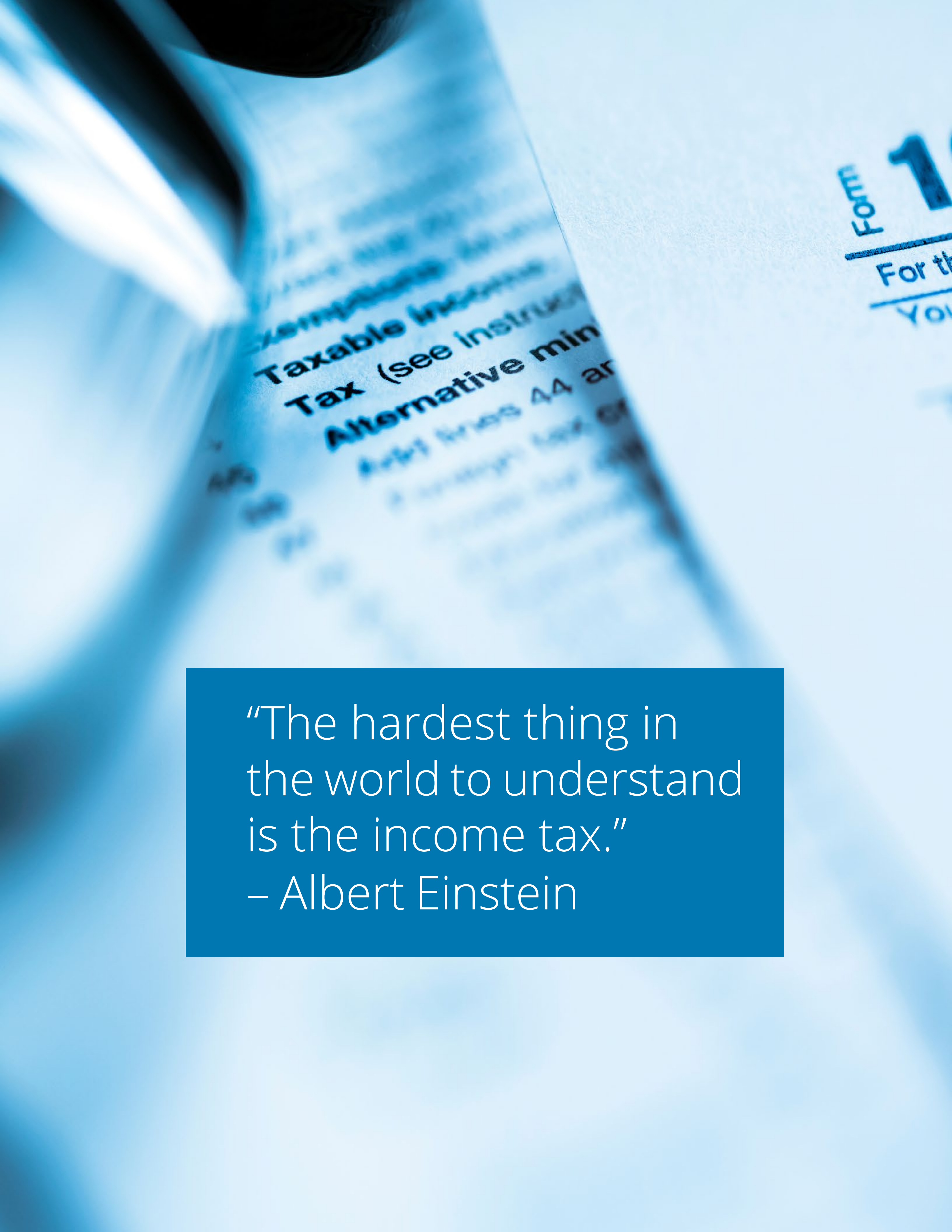

"The hardest thing in the world to understand is the income tax."
– Albert Einstein

Planning to win starts with planning to preserve

More foreign direct investment flows into the United States than into any other country. Expenditures by foreign direct investors to acquire, establish, or expand U.S. businesses totaled $333.6 billion (preliminary) in 2021.[1]

Having invested so much, many non-US companies are motivated to prosper and profit in the American marketplace. However, many organizations don't plan as well as they could to address or limit higher taxes.

Planning for multinational enterprises is subject to many external inputs—changing tax laws, the Organisation for Economic Development and Co-operation's (OECD) base erosion and profit shifting (BEPS) framework and actions, the European Union's Anti-Tax Avoidance Directives (ATAD I and II), treaty provisions, tariffs, and currency fluctuation, to name a few. These external influencers, along with ever-changing business performance, may limit predictability. It becomes harder to confirm that a multinational's worldwide corporate tax burden and related cash flow challenges are being maintained at an acceptable level while helping to mitigate tax risks.

That's why an organization's tax profile should address the ever-changing US tax landscape.

Quick choices, lingering consequences: Planning from the outset

Decisions that a company makes when first investing in the United States are unique to its own facts and circumstances and must correlate with its desired business and social objectives. Once made, they are often difficult to change without significant cost and effort. This means that at the outset it is important to define and create specialized objectives to structure a group's initial US investment. The ensuing tax implications of such objectives should be as flexible as possible.

For example, what form should the investment take? Many foreign investors set up a US corporation without giving close examination to the alternatives. In some cases, setting up a US branch of a non-US company may be more beneficial. A branch and a home office may be able to transfer intellectual property and share knowledge back and forth without creating the taxable events that arise when the intellectual property (IP) changes hands between legally distinct entities. Additionally, in other cases, it may be more tax efficient to have the branch operate as the sales hub by having its employees negotiate and execute contracts.

Similar considerations apply to the placement of IP, the location of debt, and the location and utilization of assets. Instead of creating a US corporation to build a plant, for example, a parent company may realize a lower tax burden by building the plant itself (or in a special purpose entity) and leasing the plant to a US subsidiary.

These considerations encompass the discipline of investing in the United States the way an entity's basic structure influences its financial performance.

Navigating through the complexity of investing in the United States: A plan for every stage

Sometimes a foreign parent considers leaving the United States—either for part of its business or for the entire operation. It may be beneficial to have thought in terms of cycles: from profit to loss and back again, through upturns and downturns, and through the life stages of an enterprise.

Initial investment

- Acquisition/expansion
- Continued profitability
- Repatriation of capital
- Disposition

At every stage an organization needs a plan for those that will follow and the flexibility to take on changing conditions. Those conditions can arise outside your company—or in your own boardroom. What will be important to you tomorrow that has not already occurred?

Planning from the start: Changes in US tax law

A variety of factors influence American tax policy: the need to raise revenue in an economically efficient manner, the hope to promote growth and jobs, and a desire to achieve preferred levels of progressivity within the tax system are just a few. The tax code is also rife with provisions designed to achieve various policy objectives, either by creating a disincentive for activities considered undesirable or to encourage those seen as beneficial, such as saving for retirement or producing energy from renewable sources. And, of course, there are a multitude of provisions impacting international companies in ways that can create starkly differentiated results for inbound and outbound businesses.

Keeping up with US tax law, from compliance to customized planning, is important. When a foreign company invests in a US enterprise, it plays on a field where it doesn't reside—but it does have an interest. Protecting that interest is a matter of awareness and planning.

Treaties between the United States and a parent company's country of origin can also change the tax equation, and the nature of those treaties is also subject to pressure both in Washington and abroad.

On its international travel page for Americans planning to travel abroad, the US Department of State explains, "We provide safety and security information for every country of the world to help you assess for yourself the risks of travel," providing various travel advisories for high-risk destinations.[1] When you make a significant business investment in the United States, like all jurisdictions, there are risks to consider. Much like traveling abroad, you should assess all areas of risk from day one.

A global tax network by your side: Getting started with Deloitte

Knowing the leading way to plan, structure, and operate an inbound US investment can be complex in the heat of a pending transaction. Decisions that seem secondary today may introduce costly constraints in the future. When a company's global business strategy takes it into the United States, its tax planning approach should already be in place.

At Deloitte, we recognize that addressing foreign investment in the United States is a specialized area of tax. To focus on this important area we have a US Inbound affinity group, which includes not only deep specialists within our international tax and transfer pricing teams but also professionals across all of our strategic tax service lines and offerings in the United States, including but not limited to professionals in our global customs and trade, multistate, business tax services, tax technology consulting, credits and incentives, private wealth, mergers and acquisitions, and global employment services groups.

US inbound international tax and transfer pricing specialists can help you explore potentially tax-conscious structures for acquisition, financing, repatriation, and disposition. Our broader team can also help you understand current and planned changes to US tax laws and offer tax guidance during your investment life cycle. Furthermore, the group draws upon the knowledge of a global network of colleagues who are tax specialists within their geographic locations as well as specialists across Deloitte's US consulting, audit, and advisory practices. The result is that we offer our clients "home country" knowledge, "target country" knowledge, and industry experience.

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These US professionals team with our colleagues in their home countries to bring the right global perspective to meet our clients' global tax needs. We consider a broad range of tax issues that may impact companies or individuals investing in the United States. Our teams specifically address the issues that non-US investors face when they do business in the United States and include more than 1,000 US tax specialists who focus on inbound tax planning.

Our teams ask targeted questions, develop an understanding of each client's goals and strategies, and provide advice and assistance based on a deep knowledge of federal, state, and local tax laws and regulations. We work together to overcome barriers and explore planning considerations.

Financing the US investment choice: Prior to initial investment, structuring an acquisition or expansion

Companies that plan a US investment will generally consider multiple ways to fund their US operations. Lending money from the home country parent to a wholly owned US subsidiary may be the straightforward answer.

If the organization structures the transfer as a loan, the subsidiary will owe interest to the parent company. Paying interest creates deductions that may reduce the company's US tax liability. This may create a net benefit for the organization as a whole, especially if the home country tax rate on the incoming interest payments is lower than the US rate on the same amounts.

While the principle is simple, executing takes specialized experience with technical compliance. Debt-equity provisions in the United States address whether these transactions will be respected, and in what amounts. In addition, US tax law provides rules to limit the potential benefits, from tightening the interest expense deduction rules to implementing a minimum tax on base erosion payments under the base erosion and anti-abuse tax (BEAT). Further, domestic US withholding tax on interest and potential treaty benefits with respect to interest should be considered.

A deep understanding of tax rules in the parent company can impact the tax rate on the interest payments coming back from the US entity, which in turn can impact the net savings to the entire organization.

Some organizations don't use enough reciprocal leverage to realize potential benefits. Others insert intercompany debt without proper documentation and tax analysis, leading to potential audit risk down the road. A close look—and the willingness to make frequent adjustments—may result in a debt-equity structure that achieves a myriad of business objectives.

Owning knowledge: Intellectual property

Intellectual property (IP) generates value. It is value. You can never hold it in your hand, but it can be a major component of the tax planning that goes into a US investment.

US tax legislation has changed to facilitate the movement of IP back into the United States. However, for foreign headquartered multinational companies, the benefits can be seemingly difficult to achieve. While the foreign-derived intangible income (FDII) provisions can sometimes make it beneficial for a company's IP to remain in the United States, most companies keep their IP offshore in places that have lower corporate tax rates or provide specific benefits for IP, such as the patent box regimes that have become de rigueur throughout Europe. There are exceptions to these generalizations. And even if "not here" is the answer, the question remains: where?

Circumstances may define your range of options. Remember that when you relocate the profits generated through the application of IP, you're implicitly moving the IP itself.

Seeing value to its destination: Transfer pricing and supply chain

Supply chain transformation and realignment is sometimes regarded as a science of its own, and many companies use it as a way to speed processes, reduce inventory commitments, improve productivity, and boost customer service. But it's common for companies to overlook the direct and indirect tax implications of modifications to a supply chain.

The supply chain can influence both pre-tax gains and after-tax returns. As revenues increase and/or efficiencies improve margins, a plan that's attuned to the current reality may increase taxes or create risks not originally contemplated. When applying these concerns to foreign investment in the United States, organizations should include customs compliance, warehousing locations, and transfer pricing in their supply chain calculus.

Similarly, transfer pricing is now an issue in dozens of nations that was seldom addressed, if at all, 20 years ago. International Financial Reporting Standards include significant transfer pricing requirements, and corporate accounting officers can be held personally liable for inaccuracies and shortfalls.

When capital is flowing across borders, changes in one jurisdiction may ripple into others. A global issue calls for a global plan.

Mergers and acquisitions: The right combination

Like any merger or acquisition, a cross-border transaction rises or falls on the basis of total value. Value influences the price. Considering how taxes will affect the long-term value of the transaction is important to knowing a fair price.

It's not an area in which surprises are welcome. It's not typically something you can shrug off and save for later. As with other planning considerations, the likely outcome generally improves when Tax is part of the early- stage discussion. Target screening is a good time to start talking about it.

Once tax obligations and benefits are built into a deal...

The due diligence phase may even be too late. Once tax obligations and benefits are built into a deal, it's critical to execute as planned. M&A tax planning can include considerations such as stepping up the tax basis of assets, utilizing net operating losses and other attributes, using foreign tax credits to offset tax on offshore earnings, or realigning legal entities to streamline filings. It's not unheard of for the corporate tax burden to spike if focus shifts after a deal and those plans aren't carried out. With the complex global intangible low-taxed income (GILTI) and foreign tax credit provisions, the end result may be different than expected unless a closer look is performed in advance.

Form and function: Post-acquisition restructuring

In simple cases, the foreign parent that acquires an entity in the United States may inherit a target entity's existing structure and the tax obligations that go along with it.

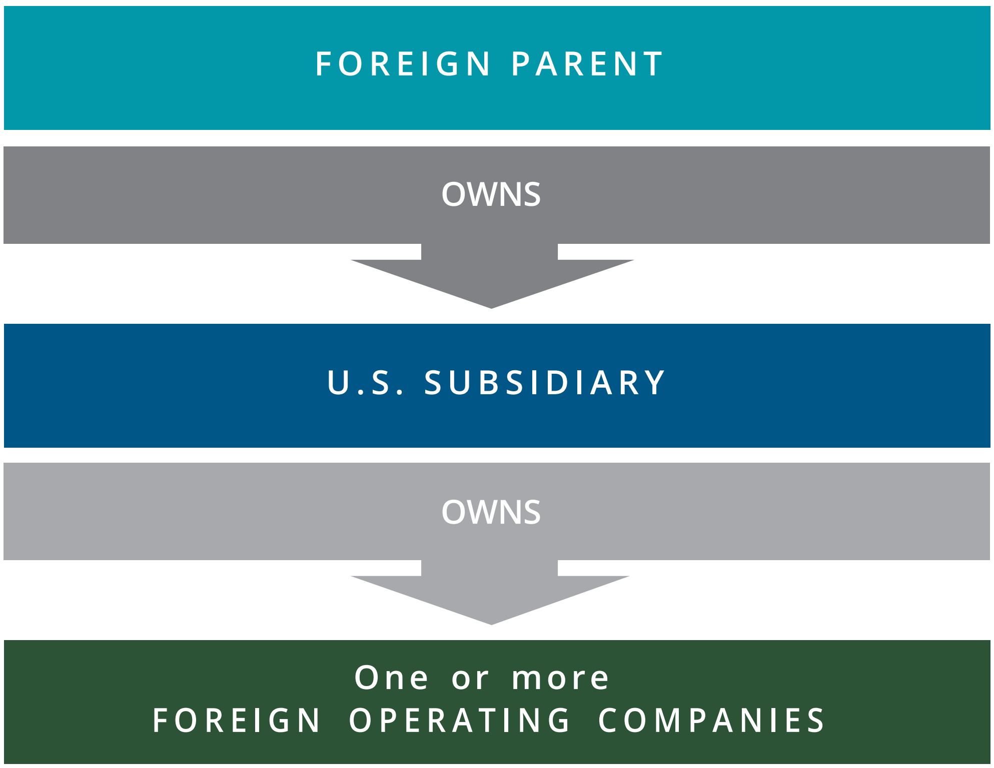
The way a foreign company structures its relationship with the US entities it owns may have a significant impact on the efficiency of its tax burden and on the way it does business.

One phenomenon that adds complexity is the "sandwich." For example, a non-US-based multinational might purchase a US multinational that, in turn, owns operating companies outside the United States. In this case, assets of the US-based component can get taxed both on the way in and on the way out. What if the foreign parent owns one operating subsidiary in the United Kingdom and another US unit that also owns a UK subsidiary—and wishes to combine them? Even if the companies are operating with a common purpose on the surface, they may involve multiple jurisdictions and costly layers of extra taxation.

What are potential remedies? The foreign parent may buy components out from under the US group. It may try to limit the future appreciation of assets subject to US tax in order to contain at least one element of the tax cost. It may benefit from a participation exemption from one or more governments to avoid double taxation. A failure to plan properly may lead to unused foreign tax credits and other lost tax attributes.

But the better remedy is to anticipate these situations and to structure a multi-company ownership appropriately.

The sandwich



Lines of ownership that cross and re-cross tax jurisdiction borders can introduce inefficiency and administrative burdens—and multiple tax liabilities that oftentimes are not fully offset by deductions or credits.

Borders within borders: Operating in multiple states

Most foreign companies that operate in the United States focus their tax planning on the federal government—yet it's not uncommon for them to pay more state and local tax than federal tax, especially with the lower federal corporate income tax rates enacted by US tax law.

State-imposed corporate taxes are based on where a company operates and not necessarily where it creates its profit or where it files its tax returns. Furthermore, on June 21, 2018, the US Supreme Court ruled to remove the historic physical presence nexus standard for sales tax purposes, significantly altering the nexus requirements for non-US companies conducting business in the United States (the "Wayfair" case). A company might operate a plant in one state and see sales activity in several others, only to find it has a significant tax obligation in each.

The burden of state and local tax can shift over time. It's common for a new US investment to pay more state and local taxes early in its life span, when it isn't generating large profits, and then to incur a greater percentage of federal tax obligations when the company is more profitable.

The fragmented nature of American taxing authorities and differing tax types, from the federal level all the way down to state, county, and municipal governments, may be unfamiliar to business leaders based in countries that operate more centrally. To address this potential exposure within the scope of your planning, it's important to understand the requirements of every jurisdiction where you'll do business—or to get help from people who do. This has become even more important with the impacts of Wayfair and the TCJA statute and regulations, which have been fully, partially, or not at all adopted by states.

Claiming State and Local Tax Incentives

Understanding available credits and incentives programs at the state, local, and federal level is important as there may be opportunities for credits and incentives that add value to your investment.

These can include reductions in locally originating operating costs (think utilities) and even a potential reduction in the overall tax bill.

Many states offer tax credits or grants to companies that bring business and employment to their borders. Training programs, site improvements, and even free land are some examples.

Benefits can arises from realizing where to look for these potential opportunities, how to apply for them, how to meet necessary requirements, and how to keep track of it all—because the complexity of credits and incentives typically multiplies as you operate in more and more locations within the United States.

The fine print: Compliance as a discipline

Given the frequent changes in US tax law—and the way taxing authority is distributed across multiple levels of government—the act of complying can be a significant job in itself, which can result in significant costs and risks, and a foreign investor should obtain the requisite information.

Based upon sales and other activities, a company may be required to file dozens of tax returns even if it operates in only one or two discrete locations. The cost of paperwork alone may be significant. The technology costs and lack of qualified tax professionals lead some companies to consider partial or full outsourcing of the tax compliance function.

Creating a compliance strategy requires a broad view backed up by fast, scrutinized, accurate reporting. It also requires a decision as to whether to outsource a portion of the compliance function. In addition to rapid changes in US tax laws across multiple jurisdictions, it's important to consider factors specific to overseas investors, such as:

- US rules limiting deductions for intra-company payments, for example, Internal Revenue Code Section 163(j);
- Approaches to address, and perhaps transfer, IP at periods of low valuation and/or when tax changes are approaching to reduce inefficiencies;
- Legislative changes that affect the applicability of US income tax treaties;
- Other changes to the tax treatment of certain intra-company payments through application of BEAT in IRC Section 59A;
- Removal of tax incentives to locate intangible income outside of the United States through FDII and the Internal Revenue Code Section 250 deduction; and
- Tax legislation effectively requiring profits above a minimum return earned by foreign subsidiaries of US entities to be included currently as income of the US entities' GILTI in Internal Revenue Code Section 951A.

Compliance is not merely a box to check. It's a discipline and a process that can have significant bottom-line effects.

Entity simplification

When you do business around the world, you may step back one day and find that your "company"—singular—is actually made up of hundreds if not thousands of distinct legal entities.

Some may correspond to specific operational or jurisdictional mandates. Some may collect dust long after their usefulness has ended. No matter where they come from, it's the rare company that has built them all into a single, coherent plan.

Every legal entity carries cost, risk, and tax exposure. What drives a company to clean house and simplify its legal structure? Typically, one of four pressure points:

1. Strategic realignment
2. Acquisition or divestiture
3. Pressure from the board
4. Tax and treasury review

When a company's entity simplification eliminates redundant cross-border transfers or eliminates a sandwich structure, it may have the potential for tax savings.

However, it also takes thought and planning to mitigate triggering new taxes. A leading approach is to invest in the analysis it takes to find potential opportunities and avoid pitfalls.

Contacts

For more information, please contact Deloitte's US Inbound Services Team:

US Inbound Service Line Leaders

US Inbound Tax Leader
Pierre-Henri Revault
Principal
Deloitte Tax LLP
New York
+1 212 436 3430
prevault@deloitte.com

Business Tax Services
Phil Giuca
Partner
Deloitte Tax LLP
New Jersey
+1 201 630 5097
pgiuca@deloitte.com

Global Employer Services
Christy Wissemeier
Managing Director
Deloitte Tax LLP
Cincinnati
+1 513 723 3089
pwissemeier@deloitte.com

International Tax
Daniel Markiewicz
Partner
Deloitte Tax LLP
New York
+1 212 436 4434
dmarkiewicz@deloitte.com

International Tax & Transfer Pricing Advisor
Michael Steinsaltz
Partner
Deloitte Tax LLP
Philadelphia
+1 215 299 4555
msteinsaltz@deloitte.com

Deloitte Private
Kevin Zinser
Partner
Deloitte Tax LLP
Dallas
+1 214 840 1088
kzinser@deloitte.com

Mergers & Acquisitions
Benjamin Handler
Principal
Deloitte Tax LLP
New York
+1 212 653 7327
bhandler@deloitte.com

Multistate Tax
Jason Wyman
Partner
Deloitte Tax LLP
Chicago
+1 312 486 9418
jwyman@deloitte.com

NFTS
Joe Carino
Principal
Deloitte Tax LLP
New Jersey
+1 212 436 4999
jocarino@deloitte.com

Private Wealth
Sha Zhang
Partner
Deloitte Tax LLP
San Francisco
+1 415 783 6215
shazhang6@deloitte.com

Transfer Pricing
Boris Nemirov
Principal
Deloitte Tax LLP
New York
+1 212 436 3351
bnemirov@deloitte.com

Contacts

US Inbound Country Tax Liaisons

Australia
Kent Kalish
Partner
Deloitte Tax LLP
Chicago
+1 847 340 1067
kkalish@deloitte.com

Canada/India
Anu Alex
Principal
Deloitte Tax LLP
New York
+1 212 436 6342
aalex@deloitte.com

China
Vivien Wang
Partner
Deloitte Tax LLP
San Jose
+1 408 704 4537
vivienwang@deloitte.com

China
Lili Zheng
Partner
Deloitte Tax LLP
New York
+1 212 653 2689
lilizheng@deloitte.com

France
Joe Gartner
Managing Director
Deloitte Tax LLP
Pittsburgh
+1 412 402 2762
jgartner@deloitte.com

Germany
David Scharnweber
Partner
Deloitte Tax LLP
New York
+1 212 436 3826
dscharnweber@deloitte.com

Israel
Avi Kamienny
Managing Director
Deloitte Tax LLP
Los Angeles
+1 213 688 3281
akamienny@deloitte.com

Israel
Ken Schulhof
Partner
Deloitte Tax LLP
New York
+1 212 436 5370
kschulhof@deloitte.com

Japan
Toshiro Ikeda
Partner
Deloitte Tax LLP
New York
+1 212 436 4956
toshikeda@deloitte.com

LATAM
Ed Gonzalez
Managing Director
Deloitte Tax LLP
San Diego
+1 619 237 6638
egonzalez@deloitte.com

Nordic countries
Daniel Markiewicz
Partner
Deloitte Tax LLP
New York
+1 212 436 4434
dmarkiewicz@deloitte.com

United Kingdom
Matvey Kats
Principal
Deloitte Tax LLP
New York
+1 646 670 6383
mkats@deloitte.com

Endnotes

1. https://travel.state.gov/content/travel/en/international-travel/International-Travel-Country-Information-Pages.html, accessed Jul. 19, 2022.

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