cutting through complexity

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Taxation of Cross-Border Mergers and Acquisitions

United States

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United States

Introduction

United States (US) law regarding mergers and acquisitions (M&A) is extensive and complex. Guidance for applying the provisions of the Internal Revenue Code of 1986, as amended (Code), is provided by the federal government, generally by the Internal Revenue Service (IRS) in revenue rulings, revenue procedures, private letter rulings, announcements, notices and Treasury Department regulations, and also by the courts.

In structuring a transaction, the types of entities involved in the transaction generally help determine the tax implications. Parties may structure a transaction in a non-taxable, partially taxable or fully taxable form. A non-taxable corporate reorganization or corporate organization generally allows the acquiring corporation to take a carryover basis in the assets of the target entity. In certain instances, a partially taxable transaction allows the acquiring corporation to take a partial step-up in the assets acquired, rather than a carryover basis. A taxable asset or share purchase provides a basis step-up in the assets or shares acquired. Certain elections made for share purchases allow the taxpayer to treat a share purchase as an asset purchase and take a basis step-up in the acquired corporation's assets.

Taxpayers generally are bound by the legal form they choose for the transaction. The particular legal structure selected by the taxpayer has substantive tax implications. Further, the IRS can challenge the tax characterization of the transaction on the basis that it does not clearly reflect the substance of the transaction.

Recent developments

This section summarizes US tax developments that occurred in 2012 and 2013.

Deemed asset purchase under section 336(e)

On 10 May 2013, the IRS issued regulations under section 336(e) that allow taxpayers in certain situations to elect to treat sales and distributions of 80 percent of a corporation's (the target) stock as taxable sales of the target's assets. Similar to a section 338 election (discussed later in this chapter), the new section 336(e) election treats a stock sale as a deemed asset sale for tax purposes, thereby providing the purchaser a step-up in the basis of the target's assets. The purchaser would be able to recover its purchase price to the extent of its depreciation and amortization deductions related to the target's assets.

Generally, to qualify for the section 336(e) election, the seller and target must be domestic corporations (or the target must be an S corporation), and the seller must dispose of the target's stock that meets the requirements of a qualified stock disposition (QSD). A QSD generally constitutes a transaction or series of transactions by which at least 80 percent of the vote and value of the target's stock is sold, exchanged, distributed or a combination thereof, by the seller or members of the seller's consolidated group (or by the target shareholders in the case of an S corporation), within a twelve-month period. A disposition for these purposes generally does not include certain transactions that result in a carryover tax basis, or any sale, exchange or distribution to a 'related person'. Importantly, a QSD may be satisfied by sale, exchange, distribution or combination thereof, to a single or multiple purchasers. Unlike the rules under section 338, the purchasers do not have to be a corporation.

The section 336(e) election applies to any QSD for which the disposition date is on or after 15 May 2013. The seller and target must enter into a written binding agreement to make a section 336(e) election and both parties should attach the election to their relevant tax return. The deemed asset disposition should be reported on Form 8883, *Asset Allocation Statement*, with adjustments as necessary to comply with the section 336(e) regulations. Where the target is an S corporation, all shareholders must sign the election statement, including those who do not dispose of their stock in the QSD.

Net investment income tax

Section 1411 imposes a 3.8 percent tax on net investment income (NII) of individuals, estates and trusts with gross income above a specified threshold as of 1 January 2013. The NII tax does not apply to S or C corporations, partnerships (but may apply to their owners), non-resident aliens, tax-exempt trusts (e.g. charitable trusts), and trusts that are not classified as trusts under the Code (e.g. real estate investment trust – REIT).

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In the case of an individual, the NII tax is applied on the lesser of the net investment income, or the excess of gross income thresholds as follows:

Filing status	Threshold amount US dollars (USD)
Married filing jointly or a surviving spouse	USD250,000
Married filing separately	USD125,000
Others	USD200,000

Source: Code section 1411(b)

NII includes three major categories of income: (i) interest, dividend, annuities, royalties and rents (unless derived in a trade or business); (ii) income from passive trades or businesses and from the business of trading financial instruments and commodities; and (iii) net gains from the disposition of property other than property held in a trade or business.

The NII tax is computed on Form 8960, *Net Investment Income Tax – Individuals, Estates, and Trusts*. Individuals report this tax on Form 1040, *US Individual Income Tax Return*, and estates and trusts report this tax on Form 1041, *US Income Tax Return for Estates and Trusts*.

Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act (FATCA) was enacted into law to address tax evasion by US taxpayers that hold unreported assets in financial accounts and undisclosed interests in foreign entities. The IRS issued final regulations on 17 January 2013, although additional IRS guidance with respect to FATCA continues to be forthcoming.

Generally, FATCA affects three groups: foreign financial institutions (FFI), non-financial foreign entities (NFFE) and withholding agents. FFIs are required to identify their substantial US account holders, obtain and track accountholders' tax information, and report it to the IRS. NFFEs are generally required to identify and report their substantial US owners, unless they qualify for an exception (e.g. where the NFFE is an 'active NFFE'). Beginning 1 July 2014, FATCA applies a 30 percent tax (effectively a penalty) that is enforced by withholding agents, who must generally withhold 30 percent from any payment of US source fixed, determinable, annual or periodical income (FDAP). Payments of gross proceeds from the disposition of property that give rise to US source dividends and interest that is paid to a foreign payee are also subject to the 30 percent withholding tax for dispositions occurring after 31 December 2016.

The 30 percent withholding tax may be eliminated in several ways. The simplest is for the payee to be a type of entity that is not subject to withholding and for such payee to provide a properly completed Form W-8BEN-E, *Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)*, to the withholding agent identifying themselves as an exempt payee (e.g. a participating FFI or active NFFE). FATCA exempts certain payments from withholding (e.g. so-called 'non-financial payment'). In this case, the withholding agent must independently determine whether the payment otherwise subject to withholding qualifies for an exception. FATCA imposes secondary liability on withholding agents for failure to properly withhold.

The payment of US source FDAP or gross proceeds must be reported on Form 1042-S, *Foreign Person's US Source Income Subject to Withholding*, and Form 1042, *Annual Withholding Tax Return for US Source Income of Foreign Persons*. Reporting of these payments is currently set to begin with the Form 1042-S and Form 1042 due 15 March 2015.

Asset purchase or share purchase

The decision to acquire assets or stock is relevant in evaluating the potential tax exposures that a purchaser may inherit from a target corporation. A purchaser of assets generally does not inherit the US tax exposures of the target, except for certain successor liability for state and local tax purposes and certain state franchise taxes. Also, an acquisition of assets constituting a trade or business may result in amortizable goodwill for US tax purposes.

However, there may be adverse tax consequences for the seller (e.g. depreciation recapture and double taxation resulting from the sale followed by distribution of the proceeds to foreign shareholders). In contrast, in a stock acquisition, the target's historical liabilities, including

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liabilities for unpaid US taxes, generally remain with the target (effectively decreasing the value of the purchaser's investment in the target's shares). In negotiated acquisitions, it is usual and recommended that the seller allow the purchaser to perform a due diligence review, which, at a minimum, should include:

- a determination of the adequacy of tax provisions/reserves in the accounts, identifying open years and pending income tax examinations
- the major differences in the pre-acquisition book and tax balance sheets
- the existence of special tax attributes (such as a net operating loss – NOL), how those attributes were generated, and whether there are any restrictions on their use
- issues relating to acquisition and post-acquisition tax planning.

Under US tax principles, the acquisition of assets or stock of a target may be structured such that gain or loss is not recognized in the exchange (tax-free reorganization). Such transactions allow the corporate structures to be rearranged and range from simple recapitalizations and contributions to complex mergers, acquisitions and consolidations.

Typically, a tax-free reorganization requires a substantial portion of the overall acquisition consideration to be in the form of stock of the acquiring corporation or a corporation that controls the acquiring corporation. However, for acquisitive asset reorganizations between corporations under common control (Cash-D reorganization), cash and/or other non-stock consideration may be used.

In addition, there may be restrictions on the disposal of stock received in a tax-free reorganization. The acquirer generally inherits the tax basis and holding period of the target's assets, as well as the target's tax attributes. However, where certain built-in loss assets are imported into the US, the tax basis of such assets may be reduced to their fair market value. In taxable transactions, the purchaser generally receives a cost basis in the assets or stock, which may result in higher depreciation deductions for taxable asset acquisitions (assuming the acquired item has a built-in gain). In certain types of taxable stock acquisitions, the purchaser may elect to treat the stock purchase as a purchase of the assets (section 338 election discussed later [see this chapter's information on purchase of shares]). Generally, US states and local municipalities respect the federal tax law's characterization of a transaction as a taxable or tax-free exchange.

Careful consideration must be given to cross-border acquisitions of stock or assets of a US target. Certain acquisitions may result in adverse tax consequences under the corporate inversion rules. Depending on the amount of shares of the foreign acquiring corporation issued to the US target shareholders, the foreign acquiring corporation may be treated as a US corporation for all US federal income tax purposes. In some cases, the US target may lose the ability to reduce any gain related to an inversion transaction by the US target's tax attributes (such as NOLs and foreign tax credits – FTC).

Purchase of assets

In a taxable asset acquisition, the purchased assets have a new cost basis for the purchaser. The seller recognizes gain (either capital or ordinary) on the amount that the purchase price exceeds its tax basis in the assets. An asset purchase generally provides the buyer with the opportunity to select the desired assets, leaving unwanted assets behind. An asset purchase may be recommended where a target has potential liabilities. While a section 338 election (described later) is treated as an asset purchase, it does not necessarily allow for the selective purchase of the target's assets or avoidance of its liabilities.

Purchase price

In a taxable acquisition of assets that constitute a trade or business, the purchaser and seller are required to allocate the purchase price among the purchased assets using a residual approach among seven asset classes described in the regulations. The buyer and seller are bound by any agreed allocation of purchase price among the assets. Contemporaneous third-party appraisals relating to asset values can be beneficial.

Depreciation and amortization

The purchase price allocated to certain tangible assets, such as inventory, property, plants and equipment, provides future tax deductions in the form of cost of sales or depreciation. As stated earlier, in an asset acquisition, the acquirer receives a cost basis in the assets acquired for tax purposes. Frequently, this results in a step-up in the depreciable basis of the assets but could result in a step-down in basis where the asset's fair market value is less than the seller's tax basis.

Most tangible assets are depreciated over tax lives ranging from three to 10 years under accelerated tax depreciation methods, thus resulting in enhanced tax deductions. Buildings are depreciable using a straight-line depreciation method generally over 39 years (residential buildings

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are depreciable over 27.5 years). Other assets, including depreciable land improvements and many non-building structures, may be assigned a recovery period of 15 to 25 years, with a less accelerated depreciation method.

In certain instances, section 179 allows taxpayers to elect to treat as a current expense the acquired cost of tangible property and computer software used in the active conduct of trade or business. For tax years beginning in 2010 through 2013, the deductible section 179 expense limitation is USD500,000 (this limitation is phased out when the taxpayer's total investment for the year exceeds USD2 million). The limit was scheduled to drop to USD25,000 in 2014 (with the phase-out level to begin at USD200,000) (in the past, Congress has several times retroactively restored the USD500,000 limitation).

Separately from section 179, so-called qualified property used in a taxpayer's trade or business or for the production of income may be subject to an additional depreciation deduction in the first year the property is placed into service. The additional depreciation – 50 percent of the cost basis, referred to as bonus depreciation – applies to qualified property acquired and placed into service after 31 December 2007 and before 1 January 2014 (with exceptions) (this information is current as of January 2014; in the past, Congress has several times retroactively extended the expiration date of the bonus depreciation deduction). Buildings are generally not qualified property; other tangible property and most computer software is qualified property. The remaining 50 percent of basis is depreciated under the general depreciation rules. Bonus depreciation automatically applies to qualified property, unless a taxpayer elects to apply the general rules to the full basis.

Under a separate election, the taxpayer foregoes any bonus depreciation and accelerates the use of certain credit carryovers from earlier years. Where the election is made, the taxpayer is required to use straight-line depreciation for all of its qualified property, with no bonus deduction.

Where both the section 179 expense and bonus depreciation are claimed for the same asset, the asset basis must first be reduced by the section 179 expense before applying the bonus depreciation rules.

Land is not depreciable for tax purposes. Accelerated depreciation, the section 179 deduction and bonus depreciation are unavailable for most assets considered predominantly used outside the US.

Generally, the capitalized cost of most acquired intangibles acquired after 10 August 1993, including goodwill, going concern value and non-compete covenants, are amortizable over 15 years. A narrow exception – the so-called anti-churning rules – exists for certain intangibles that were not previously amortizable, where they were held, used or acquired, by the purchaser (or related person) before the effective date.

Under the residual method of purchase price allocation, any premium paid that exceeds the aggregate fair market value of the acquired asset is characterized as an additional amount of goodwill and is eligible for the 15-year amortization.

Costs incurred in acquiring assets – tangible or intangible – are typically added to the purchase price and considered part of their basis, and they are depreciated or amortized along with the acquired asset. A taxpayer that produces or otherwise self-constructs tangible property may also need to allocate a portion of its indirect costs of production to basis; this can include interest expense incurred during the production period.

Tax attributes

The seller's NOLs, capital losses, tax credits and other tax attributes are not transferred to the acquirer in a taxable asset acquisition. In certain circumstances where the target has substantial tax attributes, it may be beneficial to structure the transaction as a sale of its assets so that any gain recognized may be offset by the target's tax attributes. Such a structure may also reduce the potential tax for the target's stockholder(s) on a sale of its shares where accompanied by a section 338 or 336(e) election to treat a stock purchase as a purchase of its assets for tax purposes (assuming the transaction meets the requirements for such elections; see this chapter's information on purchase of shares).

Value added tax

The US does not have a value added tax (VAT). Certain state and local jurisdictions impose sales and use taxes, gross receipts taxes and/or other transfer taxes.

Transfer taxes

The US does not impose stamp duty taxes at the federal level on transfers of tangible or intangible assets (including stock, partnership interests and limited liability company – LLC – membership interests). Certain state and local jurisdictions impose sales and use tax on the sale of certain tangible assets; however, the acquirer may be able to benefit from exemptions from sales and use tax where all or a substantial portion of the target's assets are acquired through bulk sale and/or occasional sale provisions.

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Typically, state or local transfer taxes are not applicable to the transfer of intangible assets such as stock, partnership interests and LLC membership interests. However, the majority of states and certain local jurisdictions impose a tax on the actual transfer of real estate. In certain cases, some of these jurisdictions impose a tax on the transfer of a beneficial or controlling interest in real estate.

Purchase of shares

As stated earlier, in a stock acquisition, the target's historical tax liabilities remain with target, which affects the value of the acquirer's investment in target stock. In addition, the target's tax basis in its assets generally remain unchanged. The target continues to depreciate and amortize its assets over their remaining lives using the methods it previously used. Generally, costs incurred in acquiring assets or stock are capitalized into the basis of the acquired assets or stock. Although the target retains its tax attributes in a stock acquisition, its use of its NOLs and other favorable tax attributes may be limited where it experiences what is referred to as an ownership change. (See this chapter's section on tax losses.)

Additionally, costs incurred by the acquirer and the target in connection with the stock acquisition are generally not deductible.

In a taxable purchase of the target stock, an election can be made to treat the purchase of stock as a purchase of the target's assets, provided certain requirements are satisfied. The acquirer, if eligible, can make either a unilateral election under section 338(g) (338 election) or, if available, a joint election (with the common parent of the consolidated group of which the target is a member or with shareholders of a target S corporation) under section 338(h)(10) (338(h)(10) election). Alternatively, the seller and target can make a joint election, provided they satisfy the rules under section 336(e) (336(e) election) (see information on recent developments regarding section 336(e) earlier in this chapter).

In certain circumstances involving a taxable stock sale between related parties, special rules (section 304) may re-characterize the sale as a redemption transaction in which a portion of the sale proceeds may be treated as dividend to the seller. Whether the tax consequences are adverse or beneficial depends on the facts. For example, the dividend treatment may result in the imposition of US withholding tax (WHT) at a 30 percent rate on a portion of the sale proceeds paid by a US acquirer to a foreign seller. On the other hand, the dividend treatment may be desirable on sales of foreign target stock by a US seller to a foreign acquirer, both of which are controlled by a US parent corporation. In this case, the resulting deemed dividend from the foreign acquirer and/or foreign target may allow the US seller to use FTCs.

Tax indemnities and warranties

In a stock acquisition, the target's historical tax liabilities remain with target. As such, it is important that the acquirer procures representations and warranties from the seller (or its stockholders) in the stock purchase agreements to ensure that it is not exposed to any post-transaction liabilities arising from the target's pre-transaction activities. Where significant sums are at issue, the acquirer generally performs a due diligence review of the target's tax affairs. Generally, the acquirer seeks tax indemnifications for a period through at least the expiration of the statute of limitations, including extensions. The indemnity clauses sometimes include a cap on the indemnifying party's liability or specify a dollar amount that must be reached before indemnification occurs. Please note that KPMG LLP in the US cannot and does not provide legal advice. The purpose of this paragraph is to provide general information on tax indemnities and warranties that needs to be addressed and tailored by the client's legal counsel to the facts and the client's circumstances.

Tax losses

One of the most significant limitations imposed on the target's NOLs is in section 382, which generally applies where a target that is a loss corporation undergoes an 'ownership change.' Generally, an ownership change occurs when more than 50 percent of the beneficial stock ownership of a loss corporation had changed hands over a prescribed period (generally 3 years).

The annual limitation on the amount of post-change taxable income that may be offset with pre-change NOLs is generally equal to the adjusted equity value of the loss corporation multiplied by a long-term tax-exempt rate established by the IRS. The adjusted equity value used in calculating the annual limitation is generally the equity value of the loss corporation immediately before the ownership change, subject to certain potential downward adjustments. Common such adjustments include acquisition debts pushed down to the loss corporation and certain capital contributions to the loss corporation within the two-year period prior to the ownership change.

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Crystallization of tax charges

Crystallization of tax charges is not applicable. This concept does not translate into US tax.

Pre-sale dividend

In certain circumstances, the seller may prefer to realize part of the value of its investment in the target through a pre-sale dividend. This may be attractive where the dividend is subject to tax at a rate that is lower than the tax rate on capital gains. Generally, for corporations, dividends and capital gains are subject to tax at the same federal corporate tax rate of 35 percent. However, depending on the ownership interest in the subsidiary, the seller may be entitled to various amounts of dividend-received deduction (DRD) on dividends or FTCs where the subsidiary is a foreign corporation. However, certain dividends may also result in reducing the tax basis of the target's stock by the amount of the DRD.

An individual is generally taxed on capital gains and dividends from domestic corporations and certain foreign corporations based on their overall income tax bracket. See below for long-term capital gains rates for tax years beginning after 31 December 2012. Qualified dividends are generally taxed at the general long-term capital gains rate.

Individuals are not entitled to DRDs or indirect foreign tax credits on dividends. Thus, the tax effect of a pre-sale dividend may depend on the recipient's circumstances. Each case must be examined on its facts. In certain circumstances, proceeds of pre-sale redemptions of target stock may also be treated as a dividend by the recipient stockholder (see this chapter's section on equity).

Tax bracket	Long-term capital gains and dividend tax rate
10 and 15%	0%
25, 28, 31 and 35%	15%
39.6%	20%

Source: Code section 1(h)

Transfer taxes

The US does not impose a federal stamp duty tax. Certain states may impose a tax on the transfer of a controlling interest in the ownership of a company, which generally applies only to certain assets, including real property and certain leases of real property.

Tax clearances

Generally, a clearance from the IRS is not required prior to engaging in an acquisition of stock or assets. A taxpayer can request a private letter ruling, which is a written determination issued to a taxpayer by the IRS National Office in response to a written inquiry about the tax consequences of the contemplated transactions.

Although it provides a measure of certainty on the tax consequences, the ruling process can be protracted and time-consuming and may require substantial expenditures on professional fees. Thus, the benefits of a ruling request should be carefully considered beforehand.

Private letter rulings are taxpayer-specific and can only be relied on by the taxpayers to whom they are issued. Pursuant to section 6110(k)(3), such items cannot be used or cited as precedent. Nonetheless, such rulings can provide useful information about how the IRS may view certain issues.

Choice of acquisition vehicle

A particular type of entity may be better suited for a transaction because of its potential tax treatment. Previously, companies were subject to a generally cumbersome determination process to establish entity classification. However, as of 1 January 1997, the IRS and Treasury issued regulations that allow certain eligible entities to elect to be treated as a corporation or a partnership (where the entity has more than one owner) or as a corporation or disregarded entity (where the entity has only one owner). Rules governing the default classification of domestic entities are also provided under these regulations.

A similar approach is available for classifying eligible foreign business organizations, provided such entities are not included in a prescribed list of entities that are per se corporations (i.e. always treated as corporations).

Taxpayers are advised to consider their choice of entity carefully, particularly when changing the classification of an existing entity. For example, where an association that is taxable as a corporation elects to be classified as a partnership, the election is treated as a complete liquidation of the existing corporation and the formation of a new partnership. The election could thus constitute a material realization event that might entail substantial adverse immediate or future US tax consequences.

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Local holding company

A US incorporated C-Corporation (Corporation) is often used as a holding company and/or acquisition vehicle for the acquisition of a target or a group of assets. A Corporation is generally subject to an entity-level federal income tax at the 35 percent corporate rate (lower taxable income amounts may be subject to lower rate brackets), plus any applicable state and/or local taxes. Despite the entity-level tax, a Corporation may be a useful vehicle to achieve US tax consolidation to offset income with losses between the target group members and the acquirer, subject to certain limitations (see this chapter's information on group relief/consolidation). Moreover, a Corporation may be used to push down acquisition debt so that interest may offset the income from the underlying companies or assets. However, as noted earlier, a debt pushdown may limit the use of a target's pre-acquisition losses under the section 382 regime (see this chapter's information on tax losses).

Where a non-US person is a shareholder in a Corporation, consideration should also be given to the Foreign Investment Real Property Tax Act (FIRPTA) (see next section).

Foreign parent company

Where a foreign corporation directly owns US business assets (or owns an interest in a fiscally transparent entity that conducts business in the US), it may be subject to net basis US taxes on income that is either effectively connected to the US business or earned by a US permanent establishment under a tax treaty. In addition, the foreign corporation may be subject to tax return filing obligations in the US.

Alternatively, a foreign corporation may be used as a vehicle to purchase US target stock, since foreign owners are generally not taxed on the corporate earnings of a US subsidiary corporation. However, dividends or interest from a US target remitted to a foreign corporation may be subject to US WHT at a 30 percent rate (which may be reduced under a tax treaty). Thus, careful consideration may be required where, for example, distributions from a US target are required to service debt of the foreign corporation (e.g. holding the US target through an intermediate holding company, as discussed later in this chapter).

Generally, the foreign corporation's sale of US target stock should not be subject to US taxation unless the US target was a US Real Property Holding Corporation (USRPHC) at any time during a specified measuring period. This would be the case where the fair market value of the target's US real property interests was at least 50 percent of the fair market value of its global real property interests plus certain other property used in its business during that specified measuring period. The specified measuring period generally is the shorter of the five-year period preceding the sale or other disposition and the foreign corporation's holding period for the stock. A foreign seller of USRPHC stock may be subject to US income tax on the gain at standard corporate tax rates (generally 35 percent) and a 10 percent US WHT on the amount realized, including assumption of debt (the WHT is creditable against the tax on the gain), in addition to US tax return filing obligations.

Non-resident intermediate holding company

An acquisition of the stock of a US target may be structured through a holding company resident in a jurisdiction that has an income tax treaty with the US (an Intermediate Company) potentially to benefit from favorable tax treaty WHT rates. However, the benefits of the structure may be limited under anti-treaty shopping provisions in most US treaties or under the US domestic rules (e.g. Code, regulations).

Local branch

A US branch may arise where the foreign acquirer is treated as being engaged in business in the US (e.g. where the foreign acquirer directly owns US business assets or an interest in a fiscally transparent entity under US tax laws). The income of a profitable US branch may be taxed at the 35 percent federal corporate tax rate, plus applicable state and local taxes. The US also imposes additional tax at a 30 percent rate on branch profits remitted overseas (subject to tax treaty rate reductions or exemptions).

Joint venture

Multiple acquirers may use a joint venture vehicle to purchase a US target or US assets. A joint venture may be organized either as a corporation or a fiscally transparent entity (a flow-through venture), such as a partnership or a LLC. A joint venture corporation may face issues similar to those described earlier (see this chapter's information on local holding companies).

A flow-through venture is generally not subject to US income tax at the entity level (except in some states). Instead, its owners are taxed directly on their proportionate share of the flow-through venture's earnings, whether or not distributed. Where the flow-though venture conducts business in the US, the foreign owners may be subject to net basis US taxation on their share of its earnings, as well as US WHT and US tax return filing obligations.

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Choice of acquisition funding

Generally, an acquirer (or the acquisition vehicle) finances the acquisition of a target with its own cash, issuance of debt or equity or a combination thereof. The capital structure is critical due to the potential deductibility of debt interest.

Debt

An issuer of debt may be able to deduct interest against its taxable income (see this chapter's information on deductibility of interest), whereas dividends on stock are non-deductible. Additionally, debt repayment may allow for tax-free repatriation of cash, whereas certain stock redemptions may be treated as dividends and taxed as ordinary income to the stockholder and/or be subject to US WHT.

The debt placement and its collateral security should be carefully considered to help ensure that the debt resides in entities that are likely to be able to offset interest deductions against future profits. The debt should be adequately collateralized to help ensure that the debt will be respected as a genuine indebtedness. Moreover, the US debtor may recognize current income where the debt is secured by a pledge of stock or assets of controlled foreign companies (CFC). See this chapter's information on foreign investments of a local target company.

Deductibility of interest

Interest paid or accrued during a taxable year on a genuine indebtedness of the taxpayer is generally allowed as a tax deduction during that taxable year, subject to several exceptions, some of which are described below.

For interest to be deductible, the instrument (e.g. notes) must be treated for US tax purposes as debt and not as equity. The characterization of an instrument is largely based on facts, judicial principles and IRS guidance. Although a brief list of factors cannot be considered complete, some of the major considerations in the debt-equity characterization include:

- the intention of the parties to create a debtor-creditor relationship
- the debtor's unconditional obligation to repay the outstanding amounts on a fixed maturity date
- the creditor's rights to enforce payments
- the thinness of the debtor's capital structure in relation to its total debt.

Shareholder loans must reflect arm's length terms to avoid being treated as equity. Where a debtor has limited capability to service bank debt, its guarantor may be treated as the primary borrower. As a result, the interest accrued by the debtor may be re-characterized as a non-deductible dividend to the guarantor. This may entail additional US WHT consequences where the guarantor is a foreign person.

Interest deductions may be limited for certain types of acquisition indebtedness where interest paid or incurred by a corporation during the taxable year exceeds USD5 million, subject to certain adjustments. However, this provision generally should not apply if the debt is not subordinated or convertible.

A US debtor's ability to deduct interest on debt extended or guaranteed by a related foreign person may be further limited under the earnings-stripping rules, where the debtor's debt-to-equity ratio exceeds 1.5:1. If these rules apply, interest is deductible only to the extent of 50 percent of the US debtor's adjusted taxable income, which approximates the US target's net positive cash flow. Deferred deductions for interest may be carried forward and deducted in future years, subject to applicable limitations in those years.

Other limitations apply to interest on debt owed to foreign related parties and to certain types of discounted securities. (See this chapter's information on discounted securities.)

Withholding tax on debt and methods to reduce or eliminate it

US WHT at 30 percent is imposed on interest payments to non-US lenders unless a statutory exception or favorable treaty rate applies. Further, structures that interpose corporate lenders in more favorable tax treaty jurisdictions may not benefit from a reduced WHT because of the conduit financing regulations of section 1.881-3 and anti-treaty shopping provisions in most US treaties. (See this chapter's information on intermediate entity). No US WHT is imposed on portfolio interest. Portfolio interest constitutes interest on debt held by a foreign person that is not a bank and owns less than 10 percent (by vote) of the US debtor (including options, convertible debt, etc., on an as-converted basis).

Generally, no US WHT is imposed on interest accruals until the interest is paid by the US debtor or the foreign person sells the debt instrument. Thus, US WHT on interest may be deferred on zero coupon bonds or debt issued at a discount, subject to certain limitations discussed later in this chapter. (See this chapter's information on discounted securities.)

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Checklist for debt funding

- Debt should be borne by US debtors that are likely to have adequate positive cash flows to service such debt principal and interest payments.
- Debt should satisfy the various factors of indebtedness to avoid being reclassified as equity.
- Debt must be adequately collateralized to be treated as genuine indebtedness of the issuer.
- The interest expense must qualify as deductible under the various rules limiting interest deductions discussed earlier.
- Debt between related parties must be issued under terms that are consistent with arm's length standards.
- Guarantees or pledges on the debt may be subject to the earnings-stripping rules or current income inclusion rules under the subpart F rules.

Equity

The acquisition of a US target may be financed by issuing common or preferred equity. Distributions may be classified as dividends where paid out of the US target's current or accumulated earnings and profits (E&P; similar to retained earnings). Distributions in excess of E&P are treated as the tax-free recovery of tax basis in the stock. Distributions exceeding both E&P and stock basis are treated as capital gains to the holder. US issuers of stock interests are not entitled to any deductions for dividends paid or accrued on the stock. Generally, US individual stockholders are subject to tax on dividends from a US target based on their overall income tax bracket for tax years beginning after 31 December 2012 (see this chapter's information on pre-sale dividends for the applicable tax rates). Stockholders who are corporations are subject to tax at the 35 percent rate applicable to corporations, but they are entitled to DRDs depending on their ownership interest (see this chapter's information on pre-sale dividends).

Generally, dividends paid to a foreign shareholder are subject to US WHT at 30 percent unless eligible for favorable WHT rates under a treaty. The WHT rules provide limited relief for US issuers that have no current or accumulated E&P at the time of the distribution and anticipate none during the tax year. Such a US issuer may elect out of the WHT obligation where, based on reasonable estimates, the distributions are not paid out of E&P.

Generally, no dividend should arise unless the issuer of the stock declares a dividend or the parties are required currently to accrue the redemption premium on the stock under certain circumstances. Of course, US WHT is also imposed on US source constructive (i.e. deemed paid) dividends. For example, where a subsidiary sells an asset to its parent below the asset's fair market value, the excess of the fair market value over the price paid by the parent could be treated as a constructive dividend.

Generally, gains from stock sales (including redemptions) are treated as capital gains and are not subject to US WHT (but see the discussion of FIRPTA earlier in this chapter). Certain stock redemptions may be treated as giving rise to distributions (potentially treated as dividends) where the stockholder still holds a significant amount of stock in the corporation post-redemption of either the same class or another class(es). Accordingly, the redemption may be result in ordinary income for the holder that is subject to US WHT. See this chapter's section on asset purchases and share purchases for a discussion of certain tax-free reorganizations.

Hybrids

Instruments (or transactions) may be treated as indebtedness (or a financing transaction) of the US issuer, while receiving equity treatment under the local (foreign) laws of the counterparty. This differing treatment may result in an interest deduction for the US party while the foreign party benefits from the participation exemption or FTCs that reduce its taxes under local law. Alternatively, an instrument could be treated as equity for US tax purposes and as debt for foreign tax purposes.

Discounted securities

A US issuer may issue debt instruments at a discount to increase the demand for its debt instruments. The issuer and the holder are required currently to accrue deductions and income for the original issue discount (OID) accruing over the term. However, a US issuer may not deduct OID on a debt instrument held by a related foreign person unless the issuer actually paid the OID.

A corporate issuer's deduction for the accrued OID may be limited (or even disallowed) where the debt instrument is treated as an Applicable High Yield Discount Obligation (AHYDO). In that case, the deduction is permanently disallowed for some or all of the OID if the yield on the instrument exceeds the applicable federal rate (for the month of issuance) plus 600 basis points. Any remaining OID is only deductible when paid.

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Deferred settlement

In certain acquisitions, the parties may agree that the payment of a part of the purchase price should be made conditional on the target meeting pre-established financial performance goals after the closing (earn-out). Where the goals are not met, the acquirer can be relieved of some or all of its payment obligations. An earn-out may be treated as either the payment of the contingent purchase price or ordinary employee compensation (where the seller is also an employee of the business). Acquirers generally prefer to treat the earn-out as compensation for services, so they can deduct such payments from income.

In an asset acquisition, the acquirer may capitalize the earn-out payment into the assets acquired but only in the year such earn-out amounts are actually paid. Such capitalized earn-out amounts should be depreciated/amortized over the remaining depreciable/amortizable life of the applicable assets. In a stock acquisition, the earn-out generally adds to the acquirer's basis in the target stock. Interest may be imputed on deferred earn-out payments unless the agreement specifically provides for interest.

Other considerations

Documentation of each step in the transaction and the potential tax consequences is recommended. Taxpayers generally are bound by the form they choose for a transaction, which may have material tax consequences. However, the government may challenge the characterization of a transaction on the basis that it does not reflect its substance. Thus, once parties have agreed on the form of a transaction, they are well advised to document the intent, including the applicable Code sections. Parties should also maintain documentation of negotiations and appraisals for purposes of allocating the purchase price among assets. Contemporaneous documentation of the nature of transaction costs should also be obtained. Although the parties to a transaction generally cannot dictate the tax results through the contract, documentation of the parties' intent can be helpful should the IRS challenge the characterization of the transaction.

Concerns of the seller

Generally, the seller's tax position influences the structure of the transaction. The seller may prefer to receive a portion of the value of the target in the form of a pre-sale dividend for ordinary income treatment or to take advantage of DRDs or FTCs. A sale of target stock generally results in a capital gain, except in certain related-party transactions (see this chapter's information on purchase of shares) or on certain sales of shares of a CFC. In addition, a foreign seller of a USRPHC may be subject to tax and withholding based on FIRPTA, as discussed earlier in this chapter.

A sale of assets should also result in capital gains treatment except for depreciation recapture, which may have ordinary income treatment. Where the seller has no tax attributes to absorb the gain from asset sales, gains may be deferred where the transaction qualifies as a like-kind exchange (LKE), in which the seller exchanges property for like-kind replacement property (e.g. exchange of real estate).

Alternatively, the transaction may be structured as a tax-free separation of two or more existing active trades or businesses formerly operated, directly or indirectly, by a single corporation for the preceding 5 years (spin-off). Stringent requirements must be satisfied for the separation to be treated as a tax-free spin-off.

Company law and accounting

This discussion is a high-level summary of certain accounting considerations associated with business combinations and non-controlling interests.

Accounting Standards Codification (ASC) 805 and ASC 810-10 require most identifiable assets acquired, liabilities assumed or incurred, equity instruments issued, non-controlling interests and goodwill acquired in a business combination to be recorded at 'fair value' and require non-controlling interests to be reported as a component of equity.

ASC 805-10-20 defines a business combination as a transaction or other event in which an entity (the acquirer) obtains control of one or more businesses (the acquiree or acquirees). This may be the case even where control is not obtained by purchasing equity interests or net assets, as in the case of control obtained by contract alone. This can occur, for example, when a minority shareholder's substantive participating rights expire. ASC 805-10-20 defines a business as an integrated set of activities and assets that is capable of being conducted and managed to provide a return or other economic benefit to investors, owners, members or participants.

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Business combinations are accounted for by applying the acquisition method. Companies applying this method must:

- identify the acquirer
- determine the acquisition date and acquisition-date fair value of the consideration transferred, including contingent consideration
- recognize, at their acquisition-date fair values, the identifiable assets acquired, liabilities assumed and any non-controlling interests in the acquiree (with certain exceptions)
- recognize goodwill or, in the case of a bargain purchase, a gain.

A company that obtains control but acquires less than 100 percent of an acquiree records 100 percent of the fair value of the acquiree's assets (including goodwill), liabilities and non-controlling interests, excluding certain exceptions to fair value measurement, at the acquisition date.

ASC 810-10 specifies that non-controlling interests are treated as a separate component of equity, not as a liability or other item outside of equity. Because non-controlling interests are an element of equity, increases and decreases in the parent's ownership interest that leave control intact are accounted for as equity transactions (i.e. as increases or decreases in ownership) rather than as step acquisitions or dilution gains or losses.

The carrying amount of the non-controlling interests is adjusted to reflect the change in ownership interests and any difference between the amount by which the non-controlling interests are adjusted. The fair value of the consideration paid or received is recognized directly in equity attributable to the controlling interest (i.e. additional paid-in capital).

A transaction that results in the loss of control generates a gain or loss comprising a realized portion related to the portion sold and an unrealized portion on the retained non-controlling interest, if any, that is remeasured to fair value. Similarly, a transaction that results in the gain of control could result in a gain or loss since the acquirer would account for the transaction by applying the acquisition method on that date.

Group relief/consolidation

Affiliated US corporations may elect to file consolidated federal income tax returns as members of a consolidated group. Generally, an affiliated group consists of chains of 80 percent-owned (by vote and value) corporate subsidiaries (members) having a common parent that owns such chains directly or indirectly.

The profits of one member may be offset against the current losses of another member. In most cases, gains or losses from transactions between members are deferred until the participants cease to be members of the consolidated group or otherwise cease to exist. Complex rules may limit the use of losses arising from the sale of stock of a member to unrelated third parties (i.e. unified loss rules).

Transfer pricing

Following an acquisition of a target, all transactions between the acquirer and the target must be consistent with arm's length standards. If related parties fail to conduct transactions at arm's length, the IRS may reallocate gross income, credits, deductions or allowances between the participants to prevent tax evasion or to reflect income arising from such transactions. As stated earlier, such transactions may include loans, sales of goods, leases or licenses. Contemporaneous documentation must be maintained to support intercompany transfer pricing policies.

Dual residency

Generally, the NOLs of a dual resident corporation (DRC) and a net loss attributable to a separate unit cannot be used to offset the taxable income of a US affiliate or the domestic corporation that owns the separate unit. Any such loss is a dual consolidated loss (DCL) subject to regulations contained in Treas. Reg. 1.1503(d)-1 through to 8.

A DRC is a domestic corporation subject to income tax in a foreign country on a worldwide income basis or as a resident of the foreign country. A separate unit is a foreign branch or a hybrid entity (i.e. an entity not subject to tax in the US but subject to tax in a foreign country at the entity level) that is either directly owned by a domestic corporation or indirectly owned by a domestic corporation through a partnership, trust or disregarded entity.

Limited use of a DCL may be possible where the consolidated group or domestic corporation (in the case of a standalone domestic corporation) files a special election that ensures that amounts deducted in computing the DCL will not be used to offset the income of a foreign person.

Foreign investments of a local target company

Often, a US target may be a shareholder of foreign corporations. Depending on its ownership interest, the US target may be subject to various regimes of taxation on the income or gain from such investments.

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Generally, a US target is taxed on income of a foreign subsidiary on receipt of a dividend from the subsidiary. However, under the subpart F rules, subpart F income earned by a CFC may be currently included in the income of the US target that is a US shareholder of the CFC, even where the CFC has not distributed the income.

A US shareholder is a US person that owns stock that is at least 10 percent (by vote) of the foreign corporation.

A CFC is any foreign corporation more than 50 percent of whose stock (by vote or value) is owned by US shareholders on any day during the taxable year of the foreign corporation.

Subpart F income includes, among other elements, the CFC's income from dividends, interest, royalties, rents, annuities, gains from certain commodity transactions, gains from sales of property producing passive income or no income, and foreign currency gains. In certain circumstances, subpart F income also includes the loan principal on debts extended by CFCs or loans from unrelated parties that are secured by pledges of CFC assets or stock.

Instead of the subpart F regime, a US target may be subject to taxation and interest charges resulting from owning stock in a passive foreign investment company (PFIC). A PFIC is any foreign corporation (that is not a CFC) that satisfies either of the following income or asset tests:

- at least 75 percent of its gross income for the taxable year consists of certain passive income
- at least 50 percent of the average percentage of assets consists of assets that produce certain passive income.

A US target owning PFIC stock is subject to a tax and interest charge on gains from the disposal of PFIC stock or receipt of an excess distribution from a PFIC. To avoid the PFIC tax regime, the US target may elect to treat the foreign corporation as a qualified electing fund (QEF election), with the US target being currently taxed on the QEF's earnings and capital gain, or elect to recognize the built-in gain in the PFIC stock under a mark-to-market election.

Comparison of asset and share purchases

Advantages of asset purchases

- The purchase price may be depreciated or amortized for tax purposes.
- Previous liabilities (including income tax liabilities) of the target generally are not inherited.
- Possible to acquire only part of a business.
- Profitable operations can be absorbed by loss companies in the acquirer's group, thereby effectively gaining the ability to use the losses, subject to any applicable limitations.

Disadvantages of asset purchases

- Possible need to renegotiate supply, employment and technology agreements, and change stationery.
- A higher capital outlay is usually involved (unless debts of the business are also assumed).
- May be unattractive to the seller, thereby increasing the price.
- The transaction may be subject to state and local transfer taxes.
- Benefit of any losses incurred by the target remains with the seller.

Advantages of share purchases

- Lower capital outlay (purchase net assets only).
- May be more attractive to seller, so the price could be lower.
- Buyer may benefit from tax losses of the target (subject to certain limitations).
- Buyer may benefit from existing supply or technology contracts.

Disadvantages of share purchases

- Acquire unrealized tax liability for depreciation recovery on difference between market and tax book value of assets.
- Liable for any claims or previous liabilities of the target.
- No deduction for the purchase price (assuming no section 338 or 336(e) election).
- Losses incurred by any companies in the acquirer's group in years prior to the acquisition of the target cannot be offset against certain recognized built-in gains recognized by the target.
- The use of certain tax attributes of the target may be limited after the acquisition.

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United States – Withholding tax rates

This table is based on information available up to 1 January 2014.

The following table contains the WHT rates that may be applicable to dividend, interest and royalty payments by US companies to non-residents under the tax treaties currently in force. Where, in a particular case, a treaty rate is higher than the domestic rate, the latter is applicable. Recent treaties reduce the US branch profits tax from 30 percent to the lower withholding rate applicable to dividends paid by qualifying companies. Payments to conduit companies, partnerships and other transparent entities are subject to domestic law requirements that may disallow the lower withholding rates provided by a tax treaty.

Source: *International Bureau of Fiscal Documentation, 2014.*

	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Domestic rates				
Companies:	30	30	0/30	30
Individuals:	30	N/A	0/30	30
Treaty rates				
Treaty with:				
Armenia[3]	–[4]	–	–	0
Australia	15	0/5[5]	10	5
Austria	15	5	0	0/10[6]
Azerbaijan	–	–	–	0
Bangladesh	15	10	10	10
Barbados	15	5	5	5
Belarus	–	–	–	0
Belgium	15	0/5[7]	0	0
Bulgaria	10	5	5	5
Canada	15	5	0/7/4[8]	0/10[9]
China (People's Rep.)	10	10	10	10[10]
Cyprus	15	5[11]	10	0
Czech Republic	15	5	0	0/10[12]
Denmark	15	0/5	0	0
Egypt	15	5	15	15
Estonia	15	5	10	5/10[13]
Finland	15	0/5	0	0
France	15	0/5	0	0

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	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Germany	15	0/5	0	0
Georgia	–	–	–	0
Greece	–	–	0[14]	0
Hungary	15	5	0	0
Iceland	15	5	0	0/5[15]
India	25	15	15	10/15
Indonesia	15	10[16]	10	10
Ireland	15	5	0	0
Israel	25	12.5	17.5	15
Italy	15	5[17]	10	0/5/8[18]
Jamaica	15	10	12.5	10
Japan	10	0/5[19]	10[20]	0
Kazakhstan	15	5	10	10[21]
Korea (Rep.)	15	10	12	15
Kyrgyzstan	–	–	–	0
Latvia	15	5	10	5/10
Lithuania	15	5	10	5/10
Luxembourg[22]	15	5	0	0
Malta	15	5	10	10
Mexico	10	0/5[23]	15	10
Moldova	–	–	–	0
Morocco	15	10	15	10
Netherlands	15	0/5	0	0/15[24]
New Zealand	15	0/5	10	5
Norway	15	15	0	0
Pakistan	–	15[25]	–	0
Philippines	25	20[26]	15	15
Poland	15	5	0[27]	10
Portugal	15	5[28]	10	10
Romania	10	10	10	10/15[29]

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	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Russia	10	5	0	0
Slovak Republic	15	5	0	0/10
Slovenia	15	5	5	5
South Africa	15	5	0	0
Spain	15	10[30]	10[31]	5/8/10[32]
Sri Lanka	15	15	10	5/10[33]
Sweden	15	0/5	0	0
Switzerland	15	5	0	0
Tajikistan	–	–	–	0
Thailand	15	10	15	5/8/15[34]
Trinidad and Tobago	–	–	–	0/15[35]
Tunisia	20	14	15	10/15
Turkey	20	15	15	5/10
Turkmenistan	–	–	–	0
Ukraine	15	5	0	10
United Kingdom	15	0/5	0	0
Uzbekistan	–	–	–	0
Venezuela	15	5	10	5/10

Notes:

1. The rates shown are those applied to interest paid by general obligors and interest other than "portfolio interest" and other than categories of interest that are exempt under domestic law (see 6.3.2.). Many treaties provide special withholding rates for bank loans, commercial credit transactions, and contingent interest (profit sharing) bonds and loans, for which the text of the treaty should be consulted.
2. Unless otherwise indicated, the lower non-zero rate applies if the corporate shareholder owns at least 10 percent of the voting stock or the share capital of the US corporation, depending on the applicable treaty. In addition, a number of US treaties do not permit (or contain restrictions on) reduced withholding in the case of dividends paid by RICs and REITs (see 1.2.). Special withholding rates may also apply in the case of dividends paid to qualified pension funds. The text of the treaty should be consulted.
3. The treaty concluded between the United States and the former USSR.
4. The domestic rate applies; there is no reduction under the treaty.
5. The 0 percent rate applies if the corporate shareholder owns 80 percent or more of the voting stock of the US corporation for the 12-month period ending on the date the dividends are declared and qualifies under certain provisions of the limitation on benefits article of the treaty.
6. The higher rate applies to film royalties.
7. The 0 percent rate applies if the corporate shareholder owns 80 percent or more of the voting stock of the US corporation for the 12-month period ending on the date on which entitlement to the dividend is determined and qualifies under certain provisions of the limitation on benefits article of the treaty.
8. The 0 percent rate applies to interest paid or credited between unrelated persons on or after 1 January 2008. The 7 percent rate applies to interest paid or credited between related persons, as defined in the treaty, during the 2008 calendar year. The 4 percent rate applies to interest paid or credited between related persons during the 2009 calendar year. A 0 percent rate applies to interest paid or credited between related persons on or after 1 January 2010.
9. The lower rate applies to royalties for certain copyrights, excluding films, and payments for the use or right to use computer software, patents, and other information concerning industrial, commercial or scientific experience.
10. In the case of rental of industrial, commercial or scientific equipment, the withholding rate is imposed on 70 percent of the gross royalties.
11. The lower rate applies if (i) the corporate shareholder has owned at least 10 percent of the voting stock of the US corporation for the portion of the taxable year preceding the payment of the dividend and for the whole of the prior taxable year and (ii) not more than 25 percent of the gross income of the US corporation for the prior year was derived from interest and dividends (other than interest derived in a banking or finance business and dividends received from 50 percent or more owned subsidiaries).

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12. The lower rate applies to copyright royalties, including films.
13. The lower rate applies to the right to use industrial, commercial or scientific equipment.
14. The treaty rate does not apply to corporate shareholders controlling more than 50 percent of the voting stock of the US corporation.
15. The 5 percent rate applies to trademarks and any information concerning industrial, commercial or scientific experience provided in connection with a rental or franchise agreement that includes rights to use a trademark, and to royalties for a motion picture film or work on film or videotape or other means of reproduction for use in connection with television.
16. The lower rate applies if the corporate shareholder owns 25 percent or more of the voting stock (or in some cases share capital) of the US corporation.
17. The 5 percent rate applies if the corporate shareholder has owned at least 25 percent of the voting stock of the US corporation for the 12-month period ending on the date the dividend is declared.
18. The 0 percent rate applies to royalties for copyrights of literary, artistic or scientific works (excluding royalties for computer software, motion pictures, films, tapes or other means of reproduction used for radio or television broadcasting); the 5 percent rate applies to royalties for computer software or industrial, commercial, or scientific equipment; and the 8 percent rate applies to all other royalties.
19. The 0 percent rate applies if the Japanese company has owned directly or indirectly more than 50 percent of the voting stock of the US corporation for the 12-month period ending on the date on which entitlement to the dividend is determined. The 5 percent rate applies if the Japanese company owns directly or indirectly at least 10 percent of the voting stock of the US corporation on the date on which entitlement to the dividend is determined. Under the protocol signed on 24 January 2013, which had not yet entered into force on the date of publication, the conditions for the 0 percent withholding rate on dividends paid by subsidiaries are amended to require stock ownership of at least 50 percent (in lieu of more than 50 percent) and to require a holding period of 6 months (in lieu of 12 months).
20. Under the protocol signed on 24 January 2013, which had not yet entered into force on the date of publication, the withholding rate for interest, other than contingent interest, will be reduced from 10 percent to 0 percent.
21. The withholding tax on payments for the right to use industrial, commercial or scientific property can, at the election of the beneficial owner, be computed on a net basis.
22. The treaty does not apply to Luxembourg holding companies and other Luxembourg companies that enjoy similar special fiscal treatment, including investment companies within the meaning of the Act dated 30 March 1988.
23. The 0 percent rate applies if the corporate shareholder (i) owns 80 percent or more of the voting stock of the US corporation for the 12-month period ending on the date the dividends are declared and (ii) owned at least 80 percent of such stock prior to 1 October 1998 or qualifies under certain provisions of the limitation on benefits article of the treaty.
24. The 15 percent rate applies if the royalty is paid to a permanent establishment of a Netherlands enterprise located in a third jurisdiction and the aggregate rate of tax imposed by the Netherlands and the third jurisdiction is less than 60 percent of the US corporate income tax rate, unless the royalty is paid for the use or right to use intangible property produced or developed by the permanent establishment itself.
25. The lower rate applies if the corporate shareholder owns more than 50 percent of the voting power of the US corporation.
26. The lower rate applies if the corporate shareholder has owned at least 10 percent of the voting stock of the US corporation for the portion of the taxable year preceding the payment of the dividend and for the whole of the prior taxable year.
27. Under the treaty signed on 13 February 2013, which had not yet entered into force on the date of publication, the withholding rate for interest, other than contingent interest, will be 5 percent. The withholding rate for contingent interest will be 15 percent. The withholding rate for royalties will be 5 percent.
28. The lower rate applies if the corporate shareholder directly owns at least 25 percent of the capital of the US corporation for an uninterrupted period of 2 years prior to the date of payment of the dividend.
29. The 10 percent rate applies to royalties for copyrights of literary, artistic or scientific works, including motion picture films or films or tapes used for radio or television broadcasting. The 15 percent rate applies to royalties for patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or for knowledge, experience or skill (know-how).
30. The lower rate applies if the corporate shareholder owns 25 percent or more of the voting stock of the US corporation. Under the protocol signed on 14 January 2013, which had not yet entered into force on the date of publication, a rate of 5 percent will apply if the corporate shareholder owns directly at least 10 percent of the voting stock of the US corporation. A 0 percent rate will apply if the corporate shareholder owns directly or indirectly 80 percent or more of the voting stock of the US corporation for the 12-month period ending on the date on which entitlement to the dividend is determined and qualifies under certain provisions of the limitation on benefits article of the treaty.
31. Under the protocol signed on 14 January 2013, which had not yet entered into force on the date of publication, the withholding rate for interest, other than contingent interest, will be reduced from 10 percent to 0 percent.
32. The 5 percent rate applies to royalties for copyrights; the 8 percent rate applies to royalties for films, royalties for industrial, commercial or scientific equipment and royalties for scientific works; and the 10 percent rate applies to all other royalties. Under the protocol signed on 14 January 2013, which had not yet entered into force on the date of publication, the withholding rate for all royalties will be reduced to 0 percent.
33. The 5 percent rate applies to rentals for the use of tangible personal (movable) property.
34. The 5 percent rate applies to copyrights, including films, the 8 percent rate applies to the right to use industrial, commercial or scientific equipment, and the 15 percent rate applies to the right to use any patent, trademark, design, model, plan, secret formulae or process, or information concerning industrial, commercial or scientific experience.
35. The 0 percent rate applies to copyrights or rights to produce or reproduce any literary, dramatic, musical, or artistic work.

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