Tax on Inbound Investment

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GETTING THE DEAL THROUGH

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Tax on Inbound Investment 2019

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Thirteenth edition

Getting the Deal Through is delighted to publish the thirteenth edition of *Tax on Inbound Investment*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Ecuador and Korea.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Peter Maher of A&L Goodbody and Lew Steinberg of Merrill Lynch, for their continued assistance with this volume.

GETTING THE
DEAL THROUGH

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Acquisitions (from the buyer's perspective)

1 Tax treatment of different acquisitions

What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

Taxable acquisitions

Stock acquisitions

All assets and liabilities of the target as they exist immediately prior to the closing are assumed in the transaction. The acquirer receives a basis in the target stock acquired equal to purchase price. Absent a section 338(h)(10) election as described below, there is no step-up in the basis of the target's underlying assets and, consequently, no opportunity to utilise the purchase price paid to generate higher depreciation deductions on the target's assets. In general, sellers prefer stock sales due to possible taxation at lower capital gains rates (generally 20 per cent) and the ability to divest all of the target's liabilities. The acquirer receives the benefit of the target's historic tax attributes (eg, net operating losses (NOLs)) as they remain with the target following the acquisition.

Asset acquisitions

An asset acquisition provides the buyer with flexibility to choose which target assets to acquire and which target liabilities to assume. However, asset acquisitions generally present the seller with less opportunities to avail themselves of the lower 20 per cent US federal income tax rate on capital gains. However, a corporate seller of assets will be taxed at a rate of 21 per cent, which is marginally higher than the capital gains rate, subject to a second layer of income taxation when the sale proceeds are distributed via dividend to the target's shareholders. In an asset acquisition, the acquirer receives basis adjustments in the acquired assets, with the purchase price allocated among the assets (generally in a manner agreed upon by the acquirer and seller). Typically, acquirers prefer asset acquisitions owing to the ability to receive a step-up in basis in the target's assets (which is discussed in question 2), resulting in higher post-acquisition depreciation deductions. In general, the acquirer will not benefit from the target's tax attributes as they remain with the target after closing.

338(h)(10) election option

A section 338(h)(10) election is used where the transaction must be structured as a stock acquisition for legal purposes, but the acquirer desires a basis step-up in the target's assets so that it can receive higher post-acquisition depreciation deductions. If the parties can comply with its numerous requirements, upon making a 338(h)(10) election, old target generally is deemed to have sold all of its assets to new target, followed by a deemed liquidating distribution of the proceeds by old target to its shareholders immediately before the acquisition date. A section 338(h)(10) election can disadvantage the seller when the basis it has in the target's assets is lower than its basis in its target company stock (which is often the case). In these situations, the acquirer and seller often negotiate over additional consideration to be paid to the seller to offset some or all of the additional US federal income tax liability owed by the seller as a result of the election.

Acquisitions via tax-free reorganisation

Corporate acquisitions in the US can be accomplished via tax-free reorganisation, provided that the strict conditions to qualify under the Internal Revenue Code (the Code) are met. Tax-free reorganisations come in many forms under US tax law, but in general such reorganisations are tax-free only to the extent that stock is exchanged as consideration. Therefore, they are appropriate where the acquirer's stock will form a significant portion of the consideration tendered in the transaction. Where cash or other property (but not stock) (boot) is received in what would otherwise be a tax-free reorganisation, the boot generally is subject to US federal income tax in an amount equal to the lesser of the seller's gain or the amount of the boot received by the seller. Although these transactions are commonly referred to as 'tax-free', note that the tax that would otherwise be due upon receipt of acquirer stock is deferred rather than avoided altogether.

The types of transactions that can qualify as tax-free reorganisations for US federal income tax purposes include:

- statutory mergers under state law – target shareholders exchange their shares for acquirer stock;
- forward triangular mergers – the target corporation is merged into a subsidiary of the acquiring corporation, with the subsidiary constituting the surviving entity;
- reverse triangular mergers – a subsidiary of the acquirer is merged into the target corporation, with the target constituting the surviving entity;
- 'B' reorganisations – the acquirer exchanges its voting common or qualified preferred stock for ownership of at least 80 per cent of the 'vote and value' of the target corporation's stock. The target corporation survives as a subsidiary of the acquirer; and
- 'C' reorganisations – the acquirer exchanges its voting common or preferred stock for 'substantially all' of the target's assets. Following this exchange, the target is liquidated and transfers its assets (constituting acquirer shares and any assets not transferred to the acquirer) to its shareholders.

Qualification of a particular transaction under one of the tax-free reorganisation provisions of the Code hinges on factors such as continuity of interest (ie, a sufficient number of target shareholders are shareholders of the surviving entity following the transaction) and continuity of business enterprise (ie, continuation of the target's historic business or use of a significant portion of the target's assets following the closing), along with limitations on the levels of boot.

Note that using a non-US acquisition vehicle in the context of a tax-free reorganisation can nullify tax-free treatment as described under questions 3 and 4. Therefore, non-US acquirers that wish to avail themselves of the tax-free reorganisation provisions should form a US subsidiary to effectuate the transaction.

2 Step-up in basis

In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

An acquirer receives a step-up in basis of the target's assets in a taxable asset purchase.

When a transaction is structured as a purchase of equity in a target classified as a 'partnership' or 'corporation' for US federal income tax purposes, the acquirer may receive a step-up in basis in the business assets of the target only if certain elections pursuant to the Code are timely made (or are currently in effect). If the target is classified as a 'partnership,' a section 754 election must be (or already have been) timely made. If the target is classified as a 'corporation,' a section 338(h)(10) election must be timely made (as described in question 1).

Where acquirer receives a step-up in basis of the target's assets because the transaction is structured as a taxable asset purchase or an acquisition of equity in a 'partnership' or 'corporation' (in the case of such an equity purchase, assuming for this purpose that the elections described above have or will be made), the parties generally agree via contract upon the allocation of the transaction consideration among the acquired assets. In this regard, the target (or its owners) typically desires to allocate consideration to assets that qualify for capital gains treatment (taxable at a 20 per cent rate). On the other hand, the acquirer typically desires to allocate consideration to assets that will generate higher post-acquisition depreciation deductions.

Acquirer may be able to amortise (depreciate) goodwill and other intangibles over a 15-year period. Intangibles – and specifically goodwill – are areas in an asset acquisition (or deemed asset acquisition) where acquirer and seller could have aligned interests due to the likely availability of favourable capital gains rates for seller and the benefit that the acquirer may receive post-closing benefits related to the amortisation deductions on such intangibles.

3 Domicile of acquisition company

Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

If the acquisition company is acquiring the stock of a US corporate target, the acquisition company can be either a US or a non-US company.

If the acquisition vehicle is merging into a US corporate target, it is generally preferable that the surviving entity be a US corporate entity. Exceptions may include where the non-US acquirer anticipates incurring losses or will distribute profits out of the US branch on a current basis. The rationale supporting the preference for a US acquisition company includes the fact that use of a non-US company subjects the acquirer to possible exposure to US federal 'branch profits tax'. The branch profits tax is a 30 per cent gross basis tax (subject to treaty reductions) imposed on the 'dividend equivalent amount' of the US branch of a non-US corporation. The branch profits tax regime effectively imposes the tax on deemed withdrawals from the US branch. The purpose of the branch profits tax is to tax US branches of a non-US corporation in a similar manner to US corporations with non-US parent corporations conducting the same activities. The 30 per cent rate mirrors the US federal withholding tax rate imposed on US corporations making dividend payments to their non-US parents.

Absent the branch profits tax, US branches of foreign corporations would only pay federal income tax once at the corporate level (at a 21 per cent rate) without taxing dividends made by the non-US corporation to its shareholders. Instead, if the non-US acquirer forms a US corporate subsidiary as the acquisition vehicle, the acquirer avoids imposition of the branch profits tax and only triggers US federal income tax on dividends upon actual payment of those dividends to the non-US parent (thus controlling the timing of the imposition of US tax on dividends) – such tax being in the form of a withholding tax at a 30 per cent rate (which may be reduced via an applicable income tax treaty).

Second, use of a non-US corporate acquirer with other activities outside of the US introduces complex issues of apportioning interest expenses to the US effectively connected income of the non-US acquisition company. Using a US acquisition vehicle can provide opportunities to use leverage to generate deductions against the US taxable income of the US business activities in question.

Third, a US corporate acquirer may be better positioned to claim US federal income tax deductions for acquisition related expenses (as opposed to claiming such expenses as deductions in a non-US acquirer's home jurisdiction).

Finally, use of a foreign acquisition vehicle in a tax-free reorganisation or tax-free exchange transaction could nonetheless trigger gain recognition under section 367 (as further discussed in question 4).

4 Company mergers and share exchanges

Are company mergers or share exchanges common forms of acquisition?

Company mergers and share exchanges are common when the target's owners desire to hold acquirer equity after the deal is consummated (whether in the context of a tax-free reorganisation or for other business considerations) or when the acquirer's stock will be publicly traded following the closing and target's owners have optionality as to whether to hold or sell such stock.

Where the target company's owners will receive acquirer stock as the principal consideration in a transaction, such owners likely will be motivated to qualify the transaction as a tax-free reorganisation. There are a number of possibilities under US federal tax law to structure a transaction as a 'tax-free reorganisation,' the most common of which are discussed in question 1. However, where the acquirer is a non-US corporation, section 367 of the Code severely restricts the ability of a US owner of a target company to engage in a tax-free reorganisation. As such, non-US acquirers needing to effectuate a tax-free reorganisation generally should pursue the transaction via a US subsidiary.

One notable downside to tax-free reorganisations are that the acquirer will not receive a step-up in basis of the target company's assets, thus stripping the acquirer of any ability to avail itself of higher post-closing depreciation deductions.

5 Tax benefits in issuing stock

Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

If acquirer stock will form a substantial portion of the consideration tendered in the transaction, there is potential to utilise the tax-free reorganisation provisions of US tax law to acquire the target on a tax-free basis. A discussion of the tax-free reorganisation provisions in this context can be found at questions 1 and 3.

6 Transaction taxes

Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Regardless of how an acquisition is structured, US federal tax law imposes no transaction taxes. However, certain US states and municipalities impose transaction taxes, the types and applicable rates of which vary depending on the US jurisdiction in question. Most often, these transaction taxes are imposed on the target or its owners upon consummation of the sale. State and municipal transaction taxes imposed in any transaction could include sales and use, registration, stamp and recording taxes. The seller and acquirer in any transaction subject to transaction-based taxes usually negotiate the party ultimately responsible to bear the cost of such taxes.

7 Net operating losses, other tax attributes and insolvency proceedings

Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Limitations on net operating losses

The US federal income tax code imposes substantial limitations on the ability to utilise NOLs, tax credits and other deferred tax assets of the target corporation. The recently enacted Tax Cuts and Jobs Act of 2017 (the Act) drastically changed the rules related to the carryforward and carryback of NOLs. Prior to the Act, NOLs were generally eligible for two-year carryback and 20-year carryforward periods. Further, NOL carryovers and carrybacks could fully offset taxable income of the taxpayer (subject to other limitations under US tax law, such as section 382 limitations described below). Under the Act, the carryback of NOLs is now prohibited, but NOLs may now be indefinitely carried forward. These new carryback and carryover rules apply to any NOL arising in a taxable year ending after 31 December 2017. As a result, a target's NOLs acquired in a transaction must be tracked separately to ensure that the correct rules are applied.

The Act also imposed new limitations on the amount of NOLs that a corporation may deduct in a single tax year. This limitation is equal to the lesser of the available NOL carryover or 80 per cent of a taxpayer's pre-NOL deduction taxable income. This new NOL limitation applies only to losses arising in tax years that begin after 31 December 2017. Consequently, US targets with historic NOLs may avail themselves of the old rules in respect of such NOLs.

Layered on top of the general NOL rules, upon an 'ownership change', section 382 limits the amount of NOLs that can be used to offset post-acquisition taxable income: this limit is called the '382 Limitation'. An 'ownership change' occurs if 5 per cent or more shareholders, as a result of a triggering event (stock acquisitions and most reorganisations), increase their ownership in the loss corporation by more than 50 percentage points.

The 382 Limitation equals the product of (a) the loss corporation's value at the time of the ownership change, and (b) a designated rate of return (called the 'long-term exempt rate'). For purposes of (a), the value of the loss corporation is measured as the fair market value of all of its stock (generally immediately before the ownership change), subject to 'anti-stuffing' rules that ignore certain pre-ownership change asset additions and certain non-business assets in calculating fair market value. The long-term exempt rate is determined monthly and published by the IRS. By way of example, the long-term exempt rate for ownership changes occurring in July 2018 was 2.32 per cent. Any unused 382 Limitation can be carried over to subsequent tax years.

Section 382 also imposes a continuity of business requirement that generally must be met for two years following the ownership change. In a reorganisation context, the new loss corporation must continue the historic business of the old loss corporation or otherwise use a significant portion of the old loss corporation's assets in the new loss corporation's business throughout such two-year period.

Other limitations on tax attributes

Section 383 operates to limit the use of tax credit carryovers using the annual limitation principles of section 382.

Application of rules to bankrupt or insolvent entitles

The NOL and tax credit limitation rules discussed above also apply to corporate targets emerging from bankruptcy or acquisitions of insolvent targets.

8 Interest relief

Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

Whether an acquisition company will receive interest relief related to borrowings utilised to acquire the target company (viz, deductions for interest paid) depends on whether the acquisition vehicle is a non-US company or a US company.

If the acquisition company is a non-US company, interest relief generally becomes an issue of non-US taxation. However, to the extent the target company is a pass-through post-acquisition (eg, a 'partnership') and the non-US company is engaged in US business, it is feasible to allocate a portion of the non-US companies' worldwide interest expense as a deduction against US business income.

If the acquisition company is a US corporate subsidiary of the non-US corporate parent, then such subsidiary may be able to obtain interest relief for borrowings used to acquire the target company – or from debt pushed down by the non-US corporate parent – subject to certain limitations. For instance, as a result of the Act, interest expense deductions may be limited to 30 per cent of the subsidiary's adjusted taxable income; however, this limitation only applies to taxpayers with average annual gross receipts for the three preceding taxable years in excess of $25 million. Other limitations exist where the debt is owed to a related party, which may be the case where the US corporate subsidiary borrows money from its non-US corporate parent to acquire the target. In those circumstances, if the US corporate subsidiary is on the accrual method of accounting (which is typical for corporations), then the interest payments may not be deducted until paid. Moreover, any loan between the US corporate subsidiary and non-US corporate parent must be carefully scrutinised to ensure that the arrangement results in a true debtor-creditor relationship. Otherwise, the debt could be recast as equity, and deductions for interest paid thereon would be denied.

In respect of withholding taxes, interest paid to a non-US corporate parent (or unrelated non-US company) by a US subsidiary company will generally be subject to withholding tax at a rate of 30 per cent, subject to possible reduction under an applicable income tax treaty.

9 Protections for acquisitions

What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?

Protections for stock and business asset acquisitions

It is customary for acquirers of both stock and business assets to receive representations and warranties related to the business being acquired, including representations and warranties related to the taxation of the pre-acquisition business. The representations and warranties related to a stock acquisition are often more comprehensive than those in a business asset acquisition due to the fact that a stock acquisition results in the acquirer effectively stepping into all pre-acquisition liabilities (including assuming the risks related to pre-acquisition taxation), while the liabilities to be assumed in a business asset acquisition generally can be negotiated by the parties. Indemnification covenants granted by the sellers, sometimes secured via a post-closing escrow, typically are used to protect the acquirer from any breach of seller representations and warranties. Such indemnification covenants are often carefully negotiated to include caps and other limitations on seller liability, with such limitations varying depending on the nature of the representations and warranties in question. These protections are usually documented in a comprehensive purchase or merger agreement, with other possible ancillary agreements (eg, escrow agreements).

Taxation of indemnity payments

An indemnity payment from seller to the acquirer is normally treated as an adjustment to purchase price and, therefore, does not trigger withholding tax. Instead, the acquirer's basis in the assets acquired (whether stock or assets) would be reduced to reflect the purchase price reduction. The seller, however, would adjust the amount of gain subject to US federal income tax reported as a result of the acquisition.

Post-acquisition planning

10 Restructuring

What post-acquisition restructuring, if any, is typically carried out and why?

Post-acquisition restructuring is common and occurs for a myriad of reasons. For example, if the US target holds interests in subsidiaries that operate in non-US jurisdictions, it is common to restructure such operations such that the non-US business operations are separated from the US target. In this manner, profits from non-US operations can be free of US tax consequences, and earnings may be injected into the non-US business operations (whether through debt or equity investment) without US federal tax exposure. In addition, post-acquisition restructuring often is necessary to align or consolidate business lines and to eliminate redundancies. In many instances, post-acquisition restructuring can be accomplished via tax-free reorganisations, consolidations or spin-offs (as described in question 11).

11 Spin-offs

Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

Yes, following the acquisition of the target business, tax-neutral spin-offs are often used to separate lines of businesses held in subsidiary corporations. A tax-neutral spin-off cannot occur until the five-year anniversary of the US target's acquisition.

For US federal income tax purposes, a properly structured spin-off will result in no taxable gain to the recipient shareholders, no corporate level taxable gain, and carryover basis in the stock received in the spun-off subsidiary (generally representing the shareholder's basis in the parent corporation, apportioned between the parent corporation and spun-off corporation based on their relative fair market values).

To qualify as a tax neutral spin-off, the following requirements must be met:

- Control. The parent must control (generally ownership of 80 per cent of the total voting power and 80 per cent of each class of non-voting stock) the spun-off subsidiary immediately before the spin-off. In certain circumstances, the parent or its shareholders must also control the spun-off subsidiary immediately after the spin-off.
- Device to Distribute Earnings. The spin-off cannot principally be a device to distributing earnings and profits of parent, spun-off subsidiary or both.
- Active Trade or Business. In general, both parent and the spun-off corporation must be engaged in an active trade or business and that trade or business must have been continuously conducted throughout the five-year period ending on the date of the spin-off.
- Complete Distribution. In general, the parent must distribute all of the stock it owns prior to the spin-off in the subsidiary. The distribution must be made to the parent's shareholders in respect to their parent stock or in exchange for the parent's securities.
- Business Purpose. There must be a valid business purpose (other than tax) supporting the spin-off.
- Continuity of Interest and Business Enterprise. There are detailed rules that impose continuity and business of ownership requirements.

In general, tax attributes of the spun-off subsidiary are preserved, including NOLs, subject to whether there was an 'ownership change' that triggers the section 382 rules described in question 7.

There would be no US federal transfer taxes imposed on a spin-off, but state and local transfer taxes may apply (as discussed in question 6).

12 Migration of residence

Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

It is difficult to migrate the residence of a US acquisition or target company without triggering US federal income tax. In the case of a non-US corporate acquirer, migrating the residence of such acquirer to another non-US jurisdiction without triggering US federal income tax is largely dependent on whether the US acquirer holds US real property interests. If the non-US acquirer holds US real property interests, then migration may occur without the incidence of US federal income tax so long as the migration takes a certain transactional form and various US income tax filing obligations are met.

Migrating a US target – whether the target is a 'corporation' or 'partnership' – can be very difficult to accomplish on a tax-neutral basis. For example, section 367 can impose an 'exit-tax' on any built-in gain (but not built-in loss) inherent in a migrating US corporate target's assets. Additionally, to the extent such US corporation's assets consists of intangible property, a deemed royalty stream may be subject to taxation under section 367 of the Code. Similar US tax consequences arise when a US corporate target is liquidated into its non-US corporate acquirer, unless the non-US corporate acquirer meets several conditions, one of which is to use the assets distributed from the US corporation in a US business for 10 years following such liquidation.

Another complicated tax regime can apply where a non-US corporate acquirer purchases substantially all of the property of the US target, and the US target's owners have a threshold equity interest in the non-US corporate acquirer post-closing. Section 7874 (setting forth the 'anti-inversion' tax regime) imposes US federal income taxation as if the non-US acquiring corporation were a US corporation. The policy behind section 7874 is to discourage US companies from migrating to non-US jurisdictions. The anti-inversion regime can be extremely complex and any transaction that could become subject to its underlying rules warrants careful scrutiny.

Update and trends

The most notable hot topic in the law of tax on inbound investment in the United States is the enactment of the Tax Cuts and Job Act of 2017 (the Act) late last year. The Act made sweeping changes to the US federal tax code, many of which significantly impacted both new and existing inbound investment structures. The important changes affecting inbound US investment included:

- reduction of the federal income tax rate on corporations from 35 per cent to 21 per cent;
- substantial changes to the net operating loss deduction and carryforward rules;
- new limitations on interest expense deductions; and
- implementation of a new Base Erosion and Anti-Abuse Tax, the purpose of which is to disincentivise large corporate taxpayers from eroding the US tax base via certain deductible payments made to related non-US parties.

The Act's significant reduction of the US federal corporate income tax rate has resulted in a new focus on the use of corporations for inbound investment. Where a US corporate subsidiary can be paired with a non-US corporate parent, benefits may include: (i) limited US income tax filing exposure; and (ii) for natural persons owning beneficial interests in the US corporate subsidiary, US estate tax protection. Moreover, depending on what assets are held by the US corporate subsidiary, the non-US corporate parent, company or individual may not be subject to US federal income tax on disposal of the shares in such subsidiary.

13 Interest and dividend payments

Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

In general, US federal tax law imposes a 30 per cent withholding tax on US-source interest and dividends paid to non-US payees, subject to reduction via an applicable income tax treaty. Important exceptions to withholding on interest include debt obligations that qualify under the 'portfolio interest' rules, bank deposit interest and obligations that mature within 183 days or less. If the obligor is a corporation, to qualify as portfolio interest, the debt instrument must be in registered or bearer form, the interest must be paid to a shareholder owning less than 10 per cent of the obligor's voting stock, the interest cannot be contingent (eg, contingent on the profits of the obligor), and the non-US lender must provide the obligor an applicable Form W-8 certifying that the lender is not a US person.

14 Tax-efficient extraction of profits

What other tax-efficient means are adopted for extracting profits from your jurisdiction?

Aside from dividends and interest as discussed in question 13, royalties and compensation for services performed by a non-US corporate acquirer may present opportunities for tax-efficient extraction of profits. Compensation for services performed outside the US by employees, officers or directors of the non-US corporate acquirer are not generally subject to US federal income tax. Royalties, to the extent subject to US federal income tax, may qualifiy for reduced US withholding taxes pursuant to an applicable income tax treaty. As part of post-acquisition integration planning, the acquirer should review the US target's dealings outside the United States in light of US tax treaty benefits that may be available for intellectual property, debt and other assets.

Disposals (from the seller's perspective)

15 Disposals

How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

As discussed in the context of question 1 above, sellers usually desire stock dispositions, while acquirers generally favour asset dispositions. Both types of transactions are extremely common in the US. It is relatively uncommon that a US business would be sold via disposition of the sale of the business' non-US corporate parent, absent a larger global transaction that contemplates the sale of both US and non-US business operations.

16 Disposals of stock

Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?

Typically, the sale by a non-US parent of its shares of a US corporate subsidiary will not be subject to US federal income tax. However, if that US subsidiary owns US real property interests, then the gains on the sale of stock could be subject to US federal income tax. As US subsidiaries in the energy and natural resource industries often own substantial interests in US real property, any proposed disposal of stock in any such subsidiary should be closely reviewed as to its US federal income tax treatment.

17 Avoiding and deferring tax

If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?

See questions 1, 3 and 11 for a discussion of various tax-free reorganisation techniques available under US federal tax law.

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