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Corporate Tax 2025

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USA: Law & Practice and Trends & Developments

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Weil, Gotshal & Manges LLP

USA

Law and Practice

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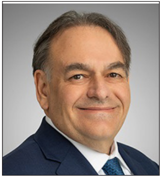

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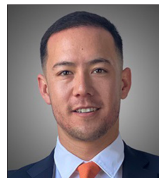

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1. Types of Business Entities, Their Residence and Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

The most commonly used business types in the United States of America (USA) include:

- sole proprietorships;
- partnerships;
- limited liability companies (LLCs); and
- corporations.

Unlike other jurisdictions, the type of business entity selected does not alone determine its US federal tax classifications.

Under the *"check-the-box"* regulations, domestic entities may be classified as corporations, partnerships or entities disregarded as separate from their owners (a *"disregarded entity"*). A business entity with two or more owners is classified either as a corporation or a partnership; and a business entity with only one owner is either classified as a corporation or as a disregarded entity. An entity is classified as *"per se corporation"* if it is organised under a US federal statute or a US state statute that describes the entity as incorporated or as a corporation, body corporate or body politic. If an entity does not meet any of these requirements, it is an *"eligible entity"* and its classification is elective. Default classification rules determine initial classification, which can be changed by filing the appropriate forms with the Internal Revenue Service (IRS); by default, a domestic eligible entity is a partnership if it has two or more owners or is a disregarded entity if it has a single owner.

In addition, certain entities (such as corporations and LLCs) can qualify for, and elect to be taxed under, certain specialised tax regimes, such as those governing S corporations, regulated investment companies (RICs) or real estate investment trusts (REITs), provided various requirements are satisfied.

Generally, the LLC is the most commonly used entity type. LLCs are hybrid entities created under state law that are neither partnerships nor corporations. From a state law perspective, they offer their members protection from personal liability for the debts of the LLC's business, much like the liability protection that a corporation offers to its shareholders. From a federal tax standpoint, the IRS treats the LLC as an eligible entity under the *"check-the-box"* rules, meaning the LLC has flexibility to be classified as either a partnership, an association taxable as a corporation (including as an S corporation, RIC or REIT) or a disregarded entity depending on its business and ownership characteristics.

1.2 Transparent Entities

Partnerships and LLCs (that have elected to be taxed as partnerships) are the most commonly used *"pass-through"* entities in the USA across industries (including private equity and hedge funds). Unlike corporations (other than S corporations, RICs or REITs, discussed further below), partnerships are not viewed as *"taxpaying"* entities. Instead, the partners are, generally speaking, liable for the federal income tax on the income (or loss) derived by the partnership. While the determination of income (or loss) for the year is determined at the entity level (treating it as the computational entity), the income or loss is allocated to the partners pursuant to their respective distributive shares. Accordingly, partnerships provide owners significant flexibility (within parameters including that the allocations have *"significant economic effect"*) in how items

of income and loss are allocated among themselves for tax purposes.

Another method of eliminating *"entity-level"* tax is for an entity to qualify for, and elect to be taxed as, an S corporation, RIC or REIT. While these regimes vary, they share a common theme – corporate income of a qualifying entity is taxed only to the shareholders, and not to the corporation itself (similar to a partnership). Due to strict ownership requirements, S corporations are available only to US *"individual"* investors and generally involve closely held businesses. RICs and REITs, by contrast, can be significantly larger and attract different investor bases based on the types of assets owned by each such entity. For example, REITs are companies that own or finance income-producing real estate across a range of property sectors, while RICs are companies that derive their income primarily from passive investment sources (ie, dividends) and generally include mutual funds, closed-end investment companies and exchange-traded funds.

1.3 Determining Residence of Incorporated Businesses

There are four classes of *"person"* for US income tax purposes:

- individuals;
- corporations;
- partnerships; and
- trusts and estates.

Under US tax rules, as under most countries' tax systems, such persons are further classified as *"resident"* or *"non-resident"* based on a variety of tests.

For individuals, the US system treats both US citizens and resident alien individuals as income tax residents. *"Resident"* aliens are defined using two tests, as follows.

- First, lawful permanent residents (ie, US green card holders) are residents so long as they hold that status.
- Second, other individuals are considered residents if they are in the USA under a day-count test. Under the day-count test, a person is considered a resident if the total number of days such person is present in the USA in the current year, plus one third of the days present in the prior year, plus one sixth of the days present in the second prior year, equals or exceeds 183 days.

For corporations, the USA generally uses the *"place of incorporation"* rule for determining tax residence, under which a corporation is *"domestic corporation"* if it is created or organised under the law of the USA, any US state or the District of Columbia. Note that a special set of rules, referred to as the *"anti-inversion rules"*, may in limited circumstances cause a non-US corporation to be treated as a US tax resident.

Generally, partnerships are determined as domestic or foreign in the same manner as corporations – ie, based on the jurisdiction of formation. However, as partnerships are not subject to income tax (see **1.2 Transparent Entities**), their status as resident or non-resident is largely irrelevant for purposes of determining their taxation (although the jurisdiction of the entity could impact on the tax treatment of the partners – eg, under a relevant income tax treaty). Trusts are classified as *"domestic"* or *"foreign"* according to whether they have a US trustee and are subject to US legal jurisdiction, and then are subject to tax as *"US persons"* or non-resident aliens according to such status. Although estates do not have a formal classification, they tend to

be categorised along principles similar to those used for trusts.

1.4 Tax Rates

The maximum US corporate income tax rate is currently 21%. In addition, US states and local governments may levy corporate income taxes on the same (or similar) tax base, but such taxes are generally deductible from the federal income tax base for corporations (subject to certain limitations). Therefore, a corporation operating in the US could face a combined tax rate in excess of 21%. On average, corporations have paid a combined US federal, state and local corporate income tax rate of approximately 26%.

The USA also applies a corporate minimum tax (effective from 1 January 2023) that generally imposes a 15% minimum tax on the financial statement income for US corporations (including consolidated groups; see **4.4 Transfer Pricing Issues**) with financial statement income of more than USD1 billion for three taxable years (or USD100 million in the case of a US corporation that is part of a non-US multinational group that has combined financial statement income of more than USD1 billion).

The fiscal year 2025 will be a transitional one from a tax policy perspective, with several significant business tax provisions set to change (or phase out) beginning at the end of the year. Although President Trump did not provide a formal tax plan as part of his 2024 campaign, he did discuss – as relevant here – lowering the corporate tax rate from 21% to 20%. In addition, in the case of domestic manufacturing, President Trump discussed lowering the effective corporate tax rate from 21% to 15%, which would tentatively be achieved through the restoration of the prior domestic production activities deduction (DPAD) set at 28.5%. Tax advisers, business leaders and individuals alike will need to evaluate the potential effect of the tax policies proposed by President Trump.

In contrast to corporations, the maximum income tax rate for individuals (including individuals invested in certain pass-through entities) is 37%. Furthermore, US states and local governments may levy additional taxes on the same (or similar) income incurred by such individuals, the rate of which fluctuates significantly between the various states and municipalities. Additionally, some US states and local governments may also levy an entity-level tax on the business entity notwithstanding its US federal tax classification.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

The US federal income tax is imposed on *"taxable income"*, which is calculated as *"gross income"* reduced by deductions allowed under the Internal Revenue Code (the *"Code"*). Gross income is defined as *"income from whatever source derived"*; thus, the USA employs a global definition of income based on the accretion concept, where any accession to wealth (other than mere appreciation of asset value with nothing more) constitutes income unless the Code expressly excludes it.

Every taxpayer must figure taxable income for an annual accounting period called *"tax year"*. The calendar year is the most common tax year; however, other tax years can be selected (ie, fiscal year). Taxpayers must use a consistent accounting method, which is a set of rules for determining when to report income and

expenses. The most commonly used accounting methods are:

- the cash method (generally used by individuals and other small businesses); and
- the accrual method.

Under the cash method, a taxpayer reports income in the tax year it receives it, and deducts expenses in the tax year in which it pays them.

Under the accrual method, the taxpayer reports income in the tax year it earns it (regardless of when payment is received) and deducts expenses in the tax year incurred (regardless of when payment is made).

2.2 Special Incentives for Technology Investments

The Code includes a wide variety of credits that can help reduce, or fully satisfy, the income tax obligations (as well as payroll tax obligations) of taxpayers across a variety of industries, and that can even simply result in a net payment from the government to the taxpayer. These credits have many rules regarding who can claim them and the timing of when, in what order and how much of the credit(s) can be used (or carried forward or backward).

Notably, the R&D tax credit provides an incentive to invest in R&D (ie, performing activities related to the development, design or improvement of products, processes, formulas, technology or software) by allowing companies to claim credits for spending on certain qualified research expenditures (QREs). The R&D tax credit has four separate components:

- the regular credit (equal to 20% of QREs above a base amount);
- the alternative simplified credit (equal to 14% of QREs above half the average of QREs over the prior three years);
- the energy research credit (equal to 20% of QREs); and
- the basic research credit (equal to 20% of QREs above a base amount).

In any year, taxpayers can take the energy research credit and the basic research credit, along with either the regular credit or the alternative simplified credit.

In addition to credits, the Code also allows taxpayers to recover certain types of R&D expenses over a specified recovery period (generally five years, but which may be extended to 15 years in cases of research conducted outside the USA). President Trump has discussed eliminating these R&D amortisation provisions and fully restoring the ability for taxpayers to immediately expense such costs (as existed under pre-Tax Cuts and Jobs Act law).

Additionally, the USA also has a regime that offers domestic corporations a deduction for *"foreign-derived intangible income"* (FDII), which is an amount that exceeds a deemed return on tangible assets. However, rather than being a patent box, the deduction for FDII is designed to neutralise the effect of global intangible low-taxed income (GILTI) (see **6.5 Taxation of Income of Non-Local Subsidiaries Under Controlled Foreign Corporation-Type Rules**) to incentivise US corporations to allocate intangible income to controlled foreign corporations (CFCs).

2.3 Other Special Incentives

In addition to the R&D tax credit (see **2.2 Special Incentives for Technology Investments**), there are several other credits that can provide tax benefits in the form of a dollar-for-dollar

reduction to tax liability. For example, there are a variety of general business credits that can be claimed by a broad range of businesses ranging from hiring certain classes of employees (eg, the work opportunity and empowerment zone employment credits) to utilising certain resources in the manufacturing process (eg, the renewable electricity production credit). Moreover, in any year, a taxpayer can choose whether to take – as a foreign tax credit (FTC) or as a deduction of foreign income – war profits and excess profit taxes paid or accrued during the tax year to any foreign country or US possession. An FTC reduces US income tax liability dollar for dollar, while a deduction reduces the US income tax liability at the marginal rate of the taxpayer.

There are generally limited incentives related to inbound investment at the federal level, such as the portfolio interest exemption (PIE), bank deposit exceptions and trading safe harbours. Very generally, the PIe, enables non-residents and foreign corporations to invest in certain obligations in the USA without being subject to US income (or withholding) tax on the interest income (see **4.1 Withholding Taxes**). The bank deposit exception allows non-US investors to deposit funds in US banking institutions without being subject to US tax on the interest earned, provided that the investment meets the statutory definition of *"deposit"* and the funds are held by persons carrying on a banking business, or certain other supervised institutions.

There also are statutory securities- and commodities-trading safe harbours that provide exceptions from being treated as engaged in a US trade or business for non-US persons trading in stocks, securities or commodities through a resident broker or other agent. Additionally, interest income received on certain qualified private activity bonds is generally exempt from US federal income tax, which enables a business to issue the bonds at a lower interest rate.

The aforementioned incentives are not intended to represent an exhaustive list of all the benefits that are available; however, they do illustrate some of the core incentives utilised by businesses in a range of industry sectors.

2.4 Basic Rules on Loss Relief

Under the US tax system, a taxpayer with deductions exceeding gross income can have a net operating loss (NOL) that may be carried to and deducted in another year. The amount of an NOL is equal to the taxpayer's gross income minus deductions, computed with certain modifications. The modifications that must be made depend on whether the taxpayer is a corporate or non-corporate taxpayer. In addition, special rules apply when determining the NOLs of a group of corporations filing a US consolidated return, which require NOLs to be computed on a consolidated basis (see **2.6 Basic Rules on Consolidated Tax Grouping**).

For NOLs arising in tax years that begin after 2020, there is no longer a carry-back period, except a two-year carry-back for certain NOLs attributable to farming losses and NOLs incurred by non-life insurance companies. The carry-forward period is unlimited for NOLs arising in post-2017 tax years; however, a 20-year carry-forward period applies to the NOLs of non-life insurance companies and pre-2018 NOLs.

In addition, post-2017 NOLs may only offset 80% of taxable income; however, this 80% limitation does not apply to non-life insurance companies. Apart from the 80% limitation, certain anti-loss trafficking rules may limit a company's NOL utilisation where there has been a sufficient change of ownership.

Individual taxpayers may offset capital gains with capital losses and, if such losses exceed the gains, ordinary income up to USD3,000 per year. Individuals may carry unused capital losses forward indefinitely. In contrast, corporate taxpayers may only offset capital gains with capital losses and may carry unused capital losses back three years and forward five years.

2.5 Imposed Limits on Deduction of Interest

In 2017, the USA passed legislation that limits the deductibility of business interest expense. Under these rules, a taxpayer's interest expense for any year is limited to the sum of:

- business interest income; plus
- 30% of adjusted taxable income (which, for 2022 and onwards, is generally equal to EBIT, rather than EBITDA); plus
- floor plan financing.

Any interest disallowed can be carried forward indefinitely and deducted in subsequent years. While certain taxpayers are exempt from this limitation (eg, certain small taxpayers and real property businesses), it applies regardless of whether related-party debt is involved, regardless of whether the debt is incurred by a sole proprietor, a corporation or a pass-through entity and regardless of whether the taxpayer is thinly capitalised. Recently, as part of President Trump's 2024 campaign, he discussed having the business interest deduction once again be based on EBITDA, rather than EBIT, which, if implemented, would enable taxpayers to deduct more business interest expense going forward.

Other rules also exist that have the potential to limit or deny interest deductions (eg, interest on certain applicable high-yield debt instruments).

In addition to the foregoing rules, the USA has also introduced two *"anti-hybrid"* rules which, if applicable, generally deny US tax deductions in certain situations involving entities and payments of interest, royalties or dividends, if such entities or payments are treated differently under US and foreign tax laws and if such different treatment results in double taxation. Furthermore, rules provided in tax regulations can recharacterise debt between related parties as *"stock or equity"* instrument if such indebtedness is issued in certain related-party transactions (see **5.7 Constraints on Related-Party Borrowing**). These rules are specifically designed to target earnings-stripping transactions.

2.6 Basic Rules on Consolidated Tax Grouping

The Code and tax regulations (and several US states) allow a group of US corporations to file a consolidated federal income tax return, which effectively allows the profits of one group member to be offset by the losses of another group member.

The consolidated return rules, which are mostly in the tax regulations, are very detailed and complex. Very generally, certain US entities classified as corporations for US federal income tax purposes may elect to join in filing a consolidated return if they are members of an *"affiliated group"*. An affiliated group is generally one or more chains of corporations connected through stock ownership with a common parent corporation, which must satisfy certain detailed stock-ownership rules with respect to the subsidiary corporations (generally requiring at least 80% ownership measured by voting power and value, but disregarding certain debt-like preferred stock). Sales, dividends and other intercompany transactions between group members are generally deferred until a transaction occurs with

a non-member (or when a member leaves the group). Groups of corporations filing consolidated returns are subject to various special rules, such as:

- rules on intercompany transactions;
- loss disallowance rules;
- loss-sharing rules;
- several liability among members of the group with respect to federal income taxes; and
- basis adjustments with respect to subsidiary member stock.

Regarding losses, a consolidated group is required to determine its NOL on a consolidated basis. For this purpose, the separate income and loss of each member is determined without taking into account any separate NOL deduction. Separate member income and losses are then aggregated and taken into account in determining the group's NOL for that year – meaning that the positive net income of some members is netted against the NOLs of other members to determine whether, on a net basis, the group has an NOL. In addition to certain general anti-loss trafficking rules (see **2.4 Basic Rules on Loss Relief**), certain loss disallowances apply only to consolidated groups.

2.7 Capital Gains Taxation

For corporate taxpayers, gains from the disposition of capital assets are subject to regularly applicable tax rates, and losses from the disposition of capital assets may only offset capital gains (see **2.4 Basic Rules on Loss Relief**).

The Code includes various non-recognition provisions under which a built-in gain may be deferred (or in the case of a tax-free subsidiary spin-off, eliminated) rather than recognised and included in taxable income in the specified transaction. For example, such provisions include:

- like-kind exchanges of real property;
- involuntary conversion; and
- certain corporate reorganisations such as mergers, stock sales or liquidations.

In addition, the 2017 tax reform introduced a regime under which taxpayers may defer or partially eliminate certain capital gains by investing in *"qualified opportunity fund"* located in any of the *"qualified opportunity zones"* enumerated by the IRS.

2.8 Other Taxes Payable by an Incorporated Business

Various other transaction taxes may apply at the state and local levels. For example, most US states impose an ad valorem real property transfer tax. In addition, beginning on 1 January 2023, stock repurchases or redemptions of more than USD1 million by a US corporation (and in certain cases, a non-US corporation) that has stock traded on an established securities market will be subject to a 1% US federal excise tax.

2.9 Incorporated Businesses and Notable Taxes

Various other taxes may apply in addition to the taxes discussed elsewhere in this chapter, such as:

- the federal excise tax imposed on insurance and reinsurance premiums paid to non-US persons;
- the federal excise tax on certain stock repurchases or redemptions (see **2.8 Other Taxes Payable by an Incorporated Business**);
- social security; and
- Medicare tax and unemployment tax imposed on employers.

In addition, US states and local governments impose various other direct taxes (ie, franchises tax) and indirect taxes (ie, excise taxes, mortgage recording taxes, telecommunications taxes or insurance premium taxes) that may vary greatly between such US states.

3. Division of Tax Base Between Corporations and Non-Corporate Businesses

3.1 Closely Held Local Businesses

As noted in **1.1 Corporate Structures and Tax Treatment**, the LLC (a hybrid-type entity) is the most commonly used entity type in the USA. This is because it not only affords liability protection for its members (similar to the protection that a corporation offers its shareholders) but also permits significant flexibility from a tax-planning perspective. Specifically, an LLC, as an eligible entity, can generally elect to be classified for federal tax purposes as a corporation, a partnership or a disregarded entity depending on its ownership. That said, by default LLCs are generally taxed like sole proprietorships or partnerships, meaning the owners are considered self-employed and generally are required to pay self-employment tax on all business profits.

Another popular form is the S corporation. As noted in **1.2 Transparent Entities**, S corporations are generally exempt from a federal income tax (meaning that any income is taxed only at the individual level) and, notably, provide certain self-employment tax benefits to their owners that are generally not available to other types of entities. Along with the tax advantages, S corporations enjoy the same protection from liability offered by corporation status. There are, however, a number of stipulations for operating as an S corporation that may disqualify or disincentivise a business seeking S corporation status. Perhaps the most important are the strict limits around shareholders, which are restricted largely to US individuals. Furthermore, unlike other types of pass-through entities (ie, partnerships), S corporations do not have flexibility when it comes to the allocation of income.

3.2 Individual Rates and Corporate Rates

Corporations in the USA are subject to what is referred to as the classic regime of corporate taxation. Specifically, corporations (other than certain types of corporations qualifying under special tax regimes – see **1.1 Corporate Structures and Tax Treatment** and **1.2 Transparent Entities**) are for the most part regarded as entirely separate legal entities and, as such, are subject to tax on their income; and shareholders are considered to receive income fully subject to tax when they receive distributions from corporations that are out of corporate earnings and profits (E&P). Thus, in the USA, corporate income is taxed twice, once at the entity level and again at the shareholder level when earnings are distributed; as a result, such system generally prevents individuals from earning income at solely corporate rates.

As discussed in **1.1 Corporate Structures and Tax Treatment** and **1.2 Transparent Entities**, certain types of corporate entities (ie, S corporations, REITs and RICs) provide a mechanism of avoiding corporate-level tax where various requirements are satisfied.

3.3 Accumulating Earnings for Investment Purposes

The retention of profits may trigger additional tax liability, such as the accumulated earnings tax (AET) (ie, a 20% penalty tax) imposed on corporations formed or availed for the purpose of avoiding the income tax with respect to their

shareholders, or the personal holding company (PHC) tax (ie, a 20% tax on undistributed PHC income) imposed on corporations that mainly derive passive-category income and the majority of which is owned by five or fewer individuals.

Notably, the PHC tax contrasts with the AET in several respects. First, if the requirements of the PHC tax are met, it applies automatically – there is no *"intent"* element that the government must establish. Second, if the PHC tax applies, the corporation must self-assess the tax by making certain filings with its annual tax return – failure to do so may subject it to additional penalties (ie, the AET is imposed by the IRS upon audit).

3.4 Sales of Shares by Individuals in Closely Held Corporations

For US individuals, gains from the disposition of capital assets (ie, shares) held for more than one year (ie, long-term capital gains) are subject to preferential capital gains tax rates – losses from the disposition of capital assets may offset capital gains and, if they exceed such gains, ordinary income up to USD3,000 per year. Any unused capital losses can be carried forward indefinitely.

Distributions by a corporation to individual shareholders are taxed as *"dividends"* only to the extent that they are paid out of the corporation's current or accumulated E&P. Dividends received from domestic and certain qualifying foreign corporations received by individual shareholders (*"Qualified Dividends"*) may be taxed at a preferential tax rate or, if not Qualified Dividends, then at regular individual tax rates. If the corporation has no E&P (or if the distribution exceeds the corporation's E&P), the individual shareholder will be allowed to treat the distribution (or the excess, in the latter case) as a return of capital, to the extent of the shareholder's basis in the stock. Any distribution in excess of basis will be treated as gain from the sale of stock.

US-sourced dividend income generally constitutes fixed or determinable annual or periodic gains, profits and income (collectively referred to as FDAP) (see **4.1 Withholding Taxes**) and is subject to a 30% withholding tax if paid to a non-US tax resident, unless reduced by an applicable treaty. Gains from the sale of stock by a non-US tax resident are generally treated as giving rise to foreign-sourced income and, as such, are not subject to US tax.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

Individuals (both US residents and non-US residents) are generally subject to the same rules discussed in **3.4 Sales of Shares by Individuals in Closely Held Corporations** with respect to dividends from, and gain on, shares in publicly traded corporations.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Non-US tax residents are generally taxed in the USA on FDAP income (ie, interest, dividends and royalties), to the extent that such items of income are not effectively connected with the conducting of a US trade or business or attributable to a permanent establishment. Such FDAP income is subject to a 30% gross basis tax that is enforced by withholding at the source, unless such tax is reduced by exemption or an applicable income tax treaty.

Notably, the PIe, generally exempts, from the otherwise applicable withholding tax previously discussed, interest paid on registered obliga-

tions held by non-US persons who own less than 10% of the voting power of the payer. The PIe, is subject to various requirements and exceptions – for example, it is not available to:

- banks receiving interest on ordinary-course loans; and
- certain CFCs.

Special withholding rules also apply in the cases of:

- dispositions of US real property interests; and
- partnerships (with foreign partners) having effectively connected income.

Dispositions of US real property interests are generally subject to the FIRPTA withholding rules, which generally require the transferee to withhold 15% on the total amount realised by the foreign person on such disposition (see **5.3 Capital Gains of Non-Residents**). Partnerships (foreign or domestic) having income effectively connected with a US trade or business (or income treated as effectively connected) generally must pay a withholding tax on the effectively connected taxable income that is allocable to its foreign partners. The tax rate for such withholding varies depending on whether the foreign partner is a corporation or an individual. Currently, the withholding tax rate for effectively connected income allocable to non-corporate foreign partners is 37%, and is 21% for corporate foreign partners.

4.2 Primary Tax Treaty Countries

The USA currently has 58 income tax treaties in force covering 66 jurisdictions. While most US income tax treaties provide reduced rates for dividends (with reduced rates generally ranging from 10% to 25%) and for interest (with reduced rates generally ranging from 0% to 17.5%), foreign investors generally must satisfy certain ownership, income and other requirements before such beneficial rates can be obtained. Of note, on 19 December 2023, the US Department of the Treasury announced the entry into force of the tax treaty between the USA and Chile. The USA-Chile treaty is only the second comprehensive bilateral tax treaty that the USA has with a South American country (the other country being Venezuela). In addition, the USA-Hungary income tax treaty was terminated, effective on 8 January 2023. However, in accordance with Article 26 (Termination) of the convention, the treaty ceased to have effect with respect to tax withheld at source on amounts paid or credited on or after 1 January 2024. For other taxes, the treaty ceased to have effect with respect to taxable periods beginning on or after 1 January 2024.

Furthermore, because most US income tax treaties include *"limitation on benefits"* article as well as other anti-treaty shopping provisions (see **4.3 Use of Treaty Country Entities by Non-Treaty Country Residents**), foreign investors are somewhat limited as to which treaty country can be used to facilitate such investment (ie, as some amount of substance in such jurisdiction is generally required).

4.3 Use of Treaty Country Entities by Non-Treaty Country Residents

Most US income tax treaties in force include *"limitation on benefits"* article and, in addition, those treaties may contain other anti-treaty shopping provisions. The 2016 US Model Income Tax Convention includes:

- the *"limitation on benefits"* article, which prevents residents of third-country jurisdictions from obtaining benefits under a treaty;
- *"triangular branch"* provision, which limits treaty benefits for income attributable to a

third-country permanent establishment if little or no tax is paid in the permanent establishment's jurisdiction;
- the *"special tax regime"* concept, which denies treaty benefits for items of income subject to a preferential tax regime; and
- a limitation that denies treaty benefits for certain payments made by expatriated entities.

Two of the most significant income tax treaties that do not include either *"limitation on benefits"* article or a triangular branch provision are the treaties with Hungary and Poland. However, new treaties that include both such provisions are currently awaiting US Senate approval to replace these treaties.

In addition to the *"limitation on benefits"* provisions, certain US income tax treaties also contain *"anti-hybrid"* provisions (such as in the *"residency"* article) that address a taxpayer's entitlement to treaty benefits for amounts derived through or paid by a hybrid entity – that is, an entity characterised as fiscally transparent in one jurisdiction and fiscally opaque in another. For example, an item of income may not be treated as *"derived by"* treaty resident if it is derived by the resident through an entity that is not resident in the same country as its owner(s) (the entity could be resident either in the source country or in a third country) and that is not treated as fiscally transparent in the owner's country of residence.

4.4 Transfer Pricing Issues

Specifically, the Code authorises the IRS to adjust items of income, deductions, credits or allowances of commonly controlled taxpayers to prevent tax evasion. The applicable standard in examining intercompany transactions is that of *"taxpayer dealing at arm's length with an uncontrolled taxpayer"* (ie, the arm's length standard), which generally is met if the results of the transaction are consistent with the results that would have been realised if uncontrolled taxpayers had engaged in a comparable transaction under comparable circumstances. The US tax regulations include detailed rules regarding how such standards may be met.

If the IRS exercises its adjustment authority, the taxpayer bears the burden of proof to show that the arm's length standard was met; and, depending on the circumstances, taxpayers may be subjected to adverse penalties for non-compliance. Consequently, it is recommended that taxpayers routinely maintain robust, contemporaneous documentation to support their transfer pricing practices given that valuation misstatement penalties and reporting penalties may apply.

The USA's aggressive transfer pricing regime has caused controversy with some of its trading partners, not all of whom have agreed with the USA's interpretation of this arm's length standard. The tax regulations, together with a greater level of enforcement activity, have resulted in an increasing number of transfer pricing issues being considered through the competent authority process under the mutual agreement article of tax treaties concluded between the USA and most of its major trading partners.

4.5 Related-Party Limited Risk Distribution Arrangements

A typical limited risk distributor (LRD) agreement may provide for the LRD to earn a predictable, fixed margin and for all residual profit or loss to inure to the principal. While the LRD agreement may provide for the principal to bear most of the LRD's costs and risks in the ordinary course of business, tax authorities might challenge whether the agreement should be respected based on such agreement's compliance with the

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transfer pricing rules and regulations, especially in circumstances (eg, the impacts of COVID-19) where significant deviations from the arm's length standard arise (see **4.4 Transfer Pricing Issues**).

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

Local transfer pricing rules and/or enforcement are generally consistent with OECD standards. That said, the OECD standards are generally less restrictive concerning market penetration strategies than the US regulations, which require a very extensive factual showing and documentation. Additionally, unlike the more restrictive US rules, OECD standards generally do not include specific rules for establishing (or benchmarking) an appropriate arm's length range.

Moreover, the primary focus of the US regulations is on whether a taxpayer has reflected arm's length results on its US income tax return, rather than focusing on the method and procedures used to set such prices. The OECD standards, by contrast, focus significantly less on results and more on whether the transfer prices were established using an arm's length manner; this therefore places considerable emphasis on factors known by the taxpayer at the time the transfer prices were established.

Finally, while the OECD standards acknowledge that penalties may play a legitimate role in improving tax compliance in the transfer pricing areas, they do not provide for any such penalty regime. In contrast, the US system employs a detailed penalty regime that includes both transaction penalties and net adjustment penalties (that escalate depending on the severity of the transfer pricing deviations and/or tax return results).

4.7 International Transfer Pricing Disputes

The USA participates in the OECD International Compliance Assurance Programme (ICAP). Accordingly, the procedures the USA takes to handle any international transfer pricing disputes are generally consistent with those set forth in the ICAP. In addition, enhanced engagement programmes, such as advance pricing agreements (APAs), mutual agreement procedures (MAPs) and other avenues, are available mechanisms in the USA for preventing and/or resolving transfer pricing disputes.

With respect to APAs, the USA was the first country to issue a formal, comprehensive set of procedures relating to the issue of binding APAs dealing with the application of the arm's length standard to intercompany transfer prices. The effect of an APA is to guarantee that the IRS will regard the results of the transfer pricing method as satisfying the arm's length standard if the taxpayer complies with the terms and conditions of the APA. In addition, when a taxpayer and the IRS enter into an APA, the US competent authority will, upon a request by the taxpayer, attempt to negotiate a bilateral APA with the competent authority of the treaty country that would be affected by the transfer pricing methodology. The IRS has encouraged taxpayers to seek such bilateral APAs through the US competent authority.

Furthermore, MAP arbitration is also available under most US tax treaties. Taxpayers should consult the MAP article under the applicable US tax treaty to determine whether it is an arbitration treaty and the extent to which mandatory arbitration applies under such treaty. Generally, US tax treaties contain a provision which would oblige the USA to make corresponding adjustments or to grant access to the MAP with

respect to the economic double taxation that may otherwise result from a primary transfer pricing adjustment (ie, paragraph 2 of Article 9 of the OECD Model Tax Convention, or the UN Model Double Taxation Convention, is included in the USA's tax treaties under the Advance Pricing and Mutual Agreement Program).

While the provisions contained in these US tax treaties do not require the competent authorities to reach an agreement eliminating double taxation, such treaties do require that the competent authority make a good faith effort to reach such an agreement. Thus, there is no guarantee that competent authority assistance will result in the elimination of double taxation in every case; however, the vast majority of cases are concluded with an agreement that avoids double taxation.

5. Key Features of Taxation of Non-Local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims Are Settled

Generally, compensating adjustments are allowed/made. A taxpayer may file a competent authority request with respect to a US federal court's final determination of its tax liability, but only for the purpose of seeking correlative relief from a foreign competent authority. Such final determinations include litigation settlements with the Office of Chief Counsel or the Department of Justice. If it accepts such a request, the US competent authority will seek correlative relief from the foreign competent authority only for the amount of such final determination and will not authorise competent authority repatriation.

5.2 Taxation Differences Between Local Branches and Local Subsidiaries of Non-Local Corporations

Generally, local branches are not taxed differently. The imposition of corporate income tax on effectively connected income (ECI) is the equivalent of the tax that would be imposed if a US trade or business were incorporated as a US subsidiary of a foreign corporation, rather than an unincorporated operation. A US subsidiary of a foreign corporation would normally pay a 30% tax on dividends distributed to the foreign corporation (without an applicable tax treaty).

To achieve a similar tax result, the foreign corporation is made liable for a 30% tax computed on its dividend equivalent amount (DEA). This is referred to as *"branch profits tax"* (BPT), although it is imposed on most income that is effectively connected to a trade or business, even if formally there is no established branch. Thus, the BPT substitutes for the taxation of the foreign corporation's shareholders while ensuring that US income is taxed twice, in accordance with the US two-tier system for taxing corporate profits (see **3.2 Individual Rates and Corporate Rates**).

5.3 Capital Gains of Non-Residents

Generally, capital gains from sales of stocks or bonds (ie, personal property) by non-US residents are exempt from US taxation and withholding (ie, as the residence of the seller generally determines whether such gain is foreign- or US-source). This rule, however, is supplanted to the extent that the stock constitutes *"US real property interest"* (USRPI), which includes an interest in stock of *"US real property holding corporation"* (USRPHC). A USRPHC is generally a US corporation that holds US real property whose fair market value is at least 50% of the fair market value of all its real property and assets

used in its trade or business. This regime is colloquially referred to as FIRPTA as it was enacted by the Foreign Investment in Real Property Tax Act.

If applicable, such tax is enforced by a withholding regime that generally requires buyers to withhold 15% of the fair market value of the disposed USRPI. Sellers of corporate stock may generally provide a certification by the corporation upon sale that the corporation is not a USRPHC and may thus avoid FIRPTA tax and withholding (although the IRS is not bound by the certification). Publicly traded corporations are subject to certain exceptions from both the substantive tax and withholding requirements.

5.4 Change of Control Provisions

There are, in general, no specific indirect transfer rules, nor any specific indirect change-of-control provisions that should be subject to local taxation.

5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates

To the extent goods or services are provided to related parties, transfer pricing principles apply (see **4.4 Transfer Pricing Issues**). Specifically, taxpayers are required to apply the arm's length standard in establishing compensation amounts for the provision of intercompany goods and/or services. Accordingly, if one member of a group of related entities provides goods or services for the benefit of (or on behalf of) another group member without charge or at a non-arm's length charge, the IRS can make appropriate reallocations to reflect an arm's length charge for those goods or services. If the services benefit more than one group member, the IRS bases the allocation on the relative benefit intended for each group member when the services are performed.

These rules generally stipulate that taxpayers must apply one of six specified transfer pricing methods in evaluating the appropriateness of their intercompany services transactions. The six specified transfer pricing methods include three transactional approaches (ie, CUSPM, GSMM and CSPM), two profit-based approaches (ie, CPM and PSM) and a cost-based safe harbour (ie, SCM).

5.6 Deductions for Payments by Local Affiliates

Management fees between controlled taxpayers are subject to US transfer pricing principles (see **4.4 Transfer Pricing Issues** and **5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates**). As discussed previously, entities should be charging an arm's length fee for the services they provide; and, if this standard is not met, the situation can become exacerbated for tax purposes if the foreign subsidiaries are profitable in their home country while the US business is reflecting losses (meaning that the expenses in the USA are really supporting the foreign operations).

In such circumstances, the IRS has the power to reallocate income and deductions between such parties in order to reflect what it believes to be the true economic nature of the cross-border activity; and, depending on the adjustments, a penalty can be imposed on an underpayment of taxes that results from improper management and administrative expenses incurred.

5.7 Constraints on Related-Party Borrowing

The Code and tax regulations contain rules that broadly impact on the tax treatment of certain related-party debt issued by US corporate borrowers to certain related parties (including non-local affiliates) (the *"Debt Recast Rules"*). Gen-

erally, the intention of these rules is to prevent erosion of the US tax base through placement of debt owed by a US corporation to a foreign affiliate; and, if applicable, they have the effect of recharacterising certain related-party debt as equity to eliminate US tax deductions on interest payments.

The Debt Recast Rules generally apply to debt issued in connection with certain enumerated transactions (*"Specified Transactions"*). Specified Transactions include:

- distributions within an expanded group;
- asset acquisitions from within the expanded group; and
- stock acquisitions within the expanded group.

In addition, the Debt Recast Rules also contain certain presumptions (such as related to the per se funding rule) that further expand the scope and applicability of the Debt Recast Rules. While the Debt Recast Rules are exceedingly complex, it should be noted that they contain many material exceptions that can mitigate or prevent the applicability of such rules in a broad range of cases.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

The USA taxes its citizens and residents (including domestic corporations) on their worldwide income directly earned from whatever source derived, which is generally taxed at a 21% rate (see **1.4 Tax Rates**). As described in later sections (see **6.3 Taxation on Dividends From Foreign Subsidiaries**), a special set of rules applies to income earned through a foreign subsidiary. That said, the USA generally permits an FTC (or deduction) against US income tax for taxes that are properly paid to other countries on income sourced to such other countries (see **2.3 Other Special Incentives**).

In addition, US taxpayers are generally permitted to utilise foreign losses to offset US-source income subject to certain recapture rules (see **6.2 Non-Deductible Local Expenses**). The USA's *"worldwide"* system of taxation is in stark contrast to many foreign jurisdictions that impose a territorial tax regime, which generally excludes (or exempts) the profits earned by non-local companies.

6.2 Non-Deductible Local Expenses

The USA generally taxes US persons on their worldwide income, including their foreign taxable income. If a taxpayer's losses (including deductions and expenses) from foreign sources exceed its foreign-source income, the excess, which is referred to as an overall foreign loss, can be used to reduce US-source income and, as such, the effective rate of tax on such income. In a subsequent year, however, the full allowance of an FTC may result in a double-tax benefit. To eliminate this benefit, foreign losses (claimed in a prior year) are recaptured by treating a portion of the foreign-source income in the later year as US-source income.

6.3 Taxation on Dividends From Foreign Subsidiaries

When a CFC makes a distribution to its US shareholder, the nature and character of that distribution must be determined. Specifically, whether the CFC has any E&P must be determined, as must the character of the E&P. If E&P exists, a distribution is generally sourced from the CFC in the following order:

- previously taxed E&P (PTEP) (ie, the E&P of a CFC attributable to income that has already been included in the gross income of a US shareholder);
- not previously taxed E&P (non-PTEP) (ie, the E&P of a CFC that has not been included in a US shareholder's gross income);
- return of capital; and
- capital gain.

Generally, PTEP distributions are excluded from a shareholder's gross income. However, a US shareholder must reduce its basis in its CFC stock by the amount of such PTEP distribution and, if a PTEP distribution exceeds stock basis, the excess results in capital gain. In contrast, non-PTEP distributions are included in a shareholder's gross income.

Notably, however, certain corporate shareholders may be eligible for a full dividends-received deduction (DRD) provided certain requirements are satisfied. The DRD, however, is not permitted for dividends received from tax-exempt organisations, certain entities subject to specialised tax regimes, or for certain hybrid dividends (or if certain holding period requirements are not satisfied). *"return of capital"* distribution is not a taxable event to the recipient US shareholder.

Finally, if a distribution exceeds the amount of non-PTEP and the US shareholder's basis in its CFC stock, any excess generally gives rise to a capital gain.

6.4 Use of Intangibles by Non-Local Subsidiaries

The use of intangible property (including transfers or licences of such intangible property) are subject to US transfer pricing principles and other provisions of the Code (see **4.4 Transfer Pricing Issues** and **5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates**), which require that arm's length compensation and/or consideration be furnished. Regarding transfers or licences of intangible property, the income must be commensurate with the income attributable to the intangible. In this regard, the IRS has authority to mandate the method used to value transfers of intangible property (in the context of outbound transfers and intercompany pricing allocations) as well as to require that the valuation of such transfers be made on an aggregate basis (or on the basis of the realistic alternative principle if the IRS determines that such method constitutes the most reliable means of valuation of such transfers).

Certain special rules apply for outbound transfers of intangible property (eg, intellectual property) by a US person to a foreign corporation in certain specified transactions. Generally, under these rules, when a US person transfers intangible property to a foreign corporation in an otherwise tax-free exchange under US tax law, the US transferor is treated as having sold the intangible property in exchange for annual royalty payments over the useful life of the intangible property (or a lump sum payment in the case of a disposition of the intangible property following the initial outbound transfer). The US transferor treats such annual inclusion and lump sum as ordinary income and royalties for purposes of determining source and the FTC limitation category.

6.5 Taxation of Income of Non-Local Subsidiaries Under Controlled Foreign Corporation-Type Rules

A foreign corporation is a CFC if US shareholders (ie, US resident persons that directly, indirectly or constructively own at least 10% of the vote or value of the foreign corporation) own stock that represents more than 50% of the vote or value

in such corporation. In addition, application of certain attribution rules may deem (for example) sister companies to be constructive CFCs. The two major consequences of CFC classification are that its 10% US shareholders must include in income:

- their pro rata share of the CFC's *"subpart F income"* (generally passive-category income such as dividends, interest, royalties, capital gains or *"foreign base company income"*) and
- their GILTI, which is generally the excess of the shareholders' pro rata share of the CFC's gross income (reduced by certain items) over a 10% deemed return on the CFC's aggregate adjusted bases of depreciable tangible property used in the CFC's trade or business.

US corporations are generally taxed on GILTI at a preferential tax rate (currently ranging from 10.5% to 13.125%, but expected to increase to a range of 13.125% to 16.406% starting in 2026), and amounts taken into account in determining subpart F income are disregarded in calculating GILTI.

In addition, a foreign corporation with predominantly passive-category income or assets may be classified as *"passive foreign investment company"* (PFIC), which may subject its owners to several onerous consequences, but which may generally be ameliorated by certain elections.

The USA imposes worldwide taxation on US business entities, and a foreign branch is not considered an entity separate from its owner. As such, foreign branch income is deemed to be derived directly by its US corporate owner and is subject to corporate income tax on a net basis. Branch income is generally determined based on the income reflected in the foreign branch's separate books and records, and the US home office is allowed an FTC on taxes paid in the branch's jurisdiction (subject to certain limitations and *"basketing"* rules).

6.6 Rules Related to the Substance of Non-Local Affiliates

There are various US judicially developed doctrines that are designed to look beyond the form of a transaction and disallow otherwise applicable tax benefits if the transaction violates the spirit of the law (see **7.1 Overarching Anti-Avoidance Provisions**). Furthermore, the limitation on benefits and other anti-treaty shopping provisions contained in US tax treaties generally look at the *"substance"* of a non-local affiliate in such jurisdiction in determining whether the benefits afforded by such treaty may apply (see **4.3 Use of Treaty Country Entities by Non-Treaty Country Residents**).

6.7 Taxation on Gain on the Sale of Shares in Non-Local Affiliates

A US corporation that is a US shareholder of a CFC will recognise a portion of any gain on the sale or exchange of stock in a CFC as a dividend, generally to the extent of the E&P in the CFC that are attributable to the stock sold or exchanged. In the case of the sale or exchange by a US corporation of stock in CFC held for one year or more, any amount received by the US corporation that is treated as a dividend may also qualify for exemption under the DRD rules (see **6.3 Taxation on Dividends From Foreign Subsidiaries**) to the extent that the sale does not result in an *"extraordinary reduction"* under the applicable rules. In the case of an extraordinary reduction, certain elections can be made (either solely by a buyer of the CFC stock or by both the buyer and the US shareholder of the CFC) to ensure qualification for the exemption under the DRD rules.

Furthermore, if a CFC sells or exchanges stock of a lower-tier CFC and any gain is treated as a dividend (similar to the rules noted above), the foreign-source portion of that dividend will be treated as subpart F income of the selling CFC for which a US shareholder may be permitted a DRD.

7. Anti-Avoidance

7.1 Overarching Anti-Avoidance Provisions

There are various judicially developed doctrines that are comparable to a general anti-abuse rule, such as the *"substance over form"*, *"step transaction"*, *"economic substance"*, *"business purpose"* and *"sham transaction"* doctrines. All these doctrines generally serve a similar purpose: to look beyond the form of a transaction and disallow otherwise applicable tax benefits if the transaction violates the spirit of the law. In addition, the economic substance doctrine was added to the Code and carries with it a 20% non-compliance penalty, which can be increased to 40% if the transaction is not properly disclosed.

Apart from the judicially developed doctrines described above, there are various statutory and regulatory provisions that provide anti-avoidance rules. Recently, the IRS released separate guidance imposing anti-avoidance-related party basis adjustment rules in the context of partnership acquisitions, and re-affirming the IRS' sentiments regarding the realisation of tax benefits upon the acquisition of control of a corporation, which, in each case, further highlight the IRS' attitudes regarding transactions where otherwise applicable tax benefits would have been realised.

8. Audit Cycles

8.1 Regular Routine Audit Cycle

The Code requires that the IRS assess, refund, credit and collect taxes within specific time limits, known as the statute of limitations. When the statute of limitations expires, the IRS can no longer assess additional tax, allow a claim for refund by the taxpayer or take collection action. The determination of statute expiry differs for assessment, refund and collection.

The basic rule is that the IRS generally has three years after a return is filed to *"assess"* tax and begin any court proceeding, though numerous exceptions exist that provide more time for the IRS (ie, six years or longer). For example, the IRS has six years to audit a return if a taxpayer omitted more than USD5,000 in income attributable to specified foreign financial assets and, notably, no time limits apply in situations where a taxpayer either failed to file or fraudulently filed tax returns. The filing of a tax return is generally the event that triggers the running of the statute of limitations on assessments. Once a tax assessment is made, the IRS generally has ten years to collect an assessed liability (subject to certain extensions).

9. BEPS

9.1 Recommended Changes

The OECD BEPS project has been continuously evolving to develop an agreement on a two-pillar approach to help address tax avoidance, and ensure coherence of international tax rules and a more transparent tax landscape. Pillar One, which applies to large multinationals, will reallocate certain amounts of taxable income to certain impacted jurisdictions, resulting in a change in effective tax rate and cash tax obligations, as

well as impacting on transfer pricing arrangements. Pillar Two, in contrast, aims to ensure that income is taxed at an appropriate rate and has several mechanisms to ensure that tax is paid.

In 2017, the USA enacted legislation generally intended to be consistent with the recommendations in the two final reports under Action 2 of the BEPS project. This legislation, and the tax regulations issued thereunder, generally neutralise double non-taxation effects of:

- inbound dividends involving hybrid arrangements, by either denying a participation exemption or requiring domestic inclusion (depending on whether the hybrid dividend is received by a domestic corporation or a CFC); and
- outbound deductible interest or royalty payments that produce a deduction/no inclusion outcome owing to hybridity by disallowing such deduction.

In addition, the USA enacted the BEAT, which targets base erosion by imposing additional tax on certain large US corporations that make deductible payments to foreign related parties. Such additional tax is designed as a 10% minimum tax (scheduled to increase to 12.5% in 2025) imposed on modified taxable income.

The USA also enacted a limitation on the deductibility of interest expense (which, very generally, is limited to 30% of EBIT) and country-by-country reporting consistent with the BEPS recommendations, and has the limitation on benefits article in most of its income tax treaties. Finally, it should be noted that the USA recently enacted a new 15% corporate minimum tax based on financial statement income (see **1.4 Tax Rates**).

The USA is still working on finalising tax regulations under the various tax provisions enacted in 2017, many of which are consistent with the BEPS recommendations. More recent legislative proposals (generally modifying the provisions introduced in 2017 and/or aligning with the minimum tax and undertaxed profits rules under Pillar Two of BEPS) have not been adopted. It is worth noting that, in the context of Pillar Two's implementation guidance, the USA has been largely successful in obtaining favourable treatment from the OECD for GILTI and transferrable energy credits, but is seeing more difficulty in gaining relief for the non-refundable R&D tax credit. This development sets the stage for subsequent rounds of negotiations between the USA and OECD as to whether Pillar Two taxes are creditable against US tax.

9.2 Government Attitudes

While the USA generally agrees that the issues addressed by BEPS (both as related to Pillars One and Two) should be remedied (which, as discussed in this chapter, the USA has taken great strides towards implementing – see **9.1 Recommended Changes**), the implementation of Pillar Two in the USA remains stalled. Passage of law to align the US international tax regime with Pillar Two appears unlikely, especially given President Trump's recently issued Executive Order to notify the OECD that any commitments related to BEPS (among other things) have no force or effect. In fact, President Trump recently issued a separate Executive Order, which provides for potential retaliatory measures against countries and their citizens that impose *"discriminatory"* or *"extraterritorial"* taxes on US citizens or corporations. Such *"discriminatory"* or *"extraterritorial"* taxes may include the so-called *"top-up tax"*; however, the effect of any retaliatory measure is unknown at this juncture.

To the extent that government attitudes change, the implementation of Pillar Two taxes abroad could have a significant impact on US-based multinational companies.

9.3 Profile of International Tax

Owing to substantial activity by US multinationals and the overall strength of the US economy, international tax has a high public profile in the USA. This is evidenced by President Trump's Executive Orders, which renege on commitments to the OECD and provide for the potential use of a Code provision, never used before, to support any retaliatory tax, which could include the doubling of certain tax rates. Given the stance of the current Trump administration regarding tariffs, it is possible that international tax will remain at the forefront of US political and economic consciousness, and the structuring of cross-border transactions could be of further import as both US and non-US companies navigate this new landscape.

9.4 Competitive Tax Policy Objective

The US government's main goal is to prevent other countries from taxing what it views as *"its"* tax base through the BEPS initiative (see **9.2 Government Attitudes**). In this respect, the USA is already balancing its competitive policy objectives against the pressures that BEPS will bring in its wake, so as to ensure that US interests, and more specifically its tax base, are appropriately safeguarded. Under the Trump administration, it remains to be seen how likely the USA is to continue engaging with the international community to help address tax avoidance and ensure coherence of international tax rules (see **9.3 Profile of International Tax**).

9.5 Features of the Competitive Tax System

While the US tax system provides many benefits for companies operating in its borders (as discussed throughout this chapter), a major drawback to the US system is its overall complexity. Specifically, the current tax law was not enacted all at once but is a result of numerous provisions added or subtracted in multiple tax bills. Often, Congress designs legislation under self-imposed constraints, such as short-term revenue goals or effects on the distribution of tax burdens among income groups. For example, the hybridity of the US international system may be seen as more vulnerable, given its complexity. Such complexity in itself can be viewed as a deterrent to cross-border investment. Another element of this complexity is the myriad laws that separately apply at the state and local level, which may or may not conform to federal provisions.

9.6 Proposals for Dealing With Hybrid Instruments

The 2017 tax reform introduced two *"anti-hybrid"* rules that generally deny US tax deductions in certain situations involving entities and payments of interest, royalties or dividends, if such entities or payments are treated differently under US and foreign tax laws and such different treatment results in double taxation (see **2.5 Imposed Limits on Deduction of Interest**). The amendments made to the Code were a direct response to Action 2 of the OECD BEPS Project designed to address hybrid and branch mismatch arrangements.

9.7 Territorial Tax Regime

The USA does not have a territorial tax regime. That said, for tax years beginning on or after 1 January 2018, US international taxation has shifted to a more *"hybrid"* system that exempts some foreign-source income (foreign-source

dividends and certain returns on foreign asset investments), but that currently taxes, at reduced rates, a much broader scope of previously deferred foreign profits (see **6.5 Taxation of Income of Non-Local Subsidiaries Under Controlled Foreign Corporation-Type Rules**) while also enacting new provisions (and regulations) designed to curtail certain types of base erosion payments. These include the following:

- the BEAT (see **9.1 Recommended Changes**);
- anti-hybrid rules (see **2.5 Imposed Limits on Deduction of Interest**);
- limitations on interest deductibility (see again **2.5 Imposed Limits on Deduction of Interest**); and
- the Debt Recast Rules (see **5.7 Constraints on Related-Party Borrowing**).

9.8 Controlled Foreign Corporation Proposals

The USA does not have a territorial tax regime (see **9.7 Territorial Tax Regime**) and already has a CFC regime in place (see **6.5 Taxation of Income of Non-Local Subsidiaries Under Controlled Foreign Corporation-Type Rules**).

9.9 Anti-Avoidance Rules

DTC limitation on benefit or anti-avoidance rules are not likely to have an impact. As discussed previously, most US income tax treaties already include *"limitation on benefits"* article, and also contain various other anti-treaty shopping provisions (see **4.3 Use of Treaty Country Entities by Non-Treaty Country Residents**).

9.10 Transfer Pricing Changes

The transfer pricing changes introduced by BEPS are generally consistent with the US transfer pricing rules and regulations; however, they do diverge in some respects (see **4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards**). For intellectual property, it is worth noting that the BEPS proposals place significantly more emphasis on the *"economic ownership"* of intangible assets, which contrasts with the US position that focuses more on *"legal ownership"*.

9.11 Transparency and Country-by-Country Reporting

The authors are not currently in favour of such provisions. Although the USA issued tax regulations requiring country-by-country reporting by US multinational enterprises, the information the government obtains is strictly confidential and used solely for tax purposes.

9.12 Taxation of Digital Economy Businesses

A number of countries have reached an agreement with the USA as to the treatment of their existing digital services taxes (DSTs), pending the implementation of Pillar One. This is known as the Unilateral Measures Compromise. This compromise, which was agreed upon by the USA, Austria, France, Italy, Spain, the United Kingdom, Turkey and India, covers the interim period between January 2022 and the earlier of either the date Pillar One formally takes effect or 31 December 2023.

Notably, under the compromise, these countries can keep their existing DSTs in place until the implementation of Pillar One; however, corporations (primarily US multinational corporations) that are subject to DSTs may receive a tax credit against future tax liabilities. While the USA had agreed to terminate certain punitive trade actions against such countries in light of the compromise, sentiments under the Trump administration have changed drastically from the prior Biden administration. It is possible that DSTs, in light of President Trump's recent Execu-

tive Orders, could be an *"extraterritorial"* or *"discriminatory"* tax subject to US retaliation; however, the interaction of such retaliatory tax in light of the complex web of US tax treaties remains uncertain (see **9.3 Profile of International Tax**).

9.13 Digital Taxation

The USA opposes unilateral action to tax digital presence (see also **9.12 Taxation of Digital Economy Businesses**).

9.14 Taxation of Offshore IP

Though such provisions have been introduced, much of the focus in the USA relates to *"outbound"* transfers of intellectual property, and as discussed previously, the use of intangible property (including transfers or licences of such intangible property) are subject to US transfer pricing principles and other provisions of the Code, which generally require the arm's length standard to be satisfied (see **6.4 Use of Intangibles by Non-Local Subsidiaries**). Accordingly, in the USA the consideration paid for an intangible asset (or use of an intangible asset) will be evaluated consistent with the statutory requirement that the consideration be commensurate with the income derived from exploitation of the intangible.

For US transfer pricing purposes, the owner of legally protected intangibles is the legal owner. However, in the case of non-legally protected intangibles, the owner is the party with *"practical control"* over the intangible (ie, the party that possesses legal ownership under intellectual property law or that holds rights constituting an intangible pursuant to contractual terms (such as a licence). When the legal ownership standard is inconsistent with *"economic substance"*, these rules may be dismissed, and the substance of the overall arrangement is given effect.

Trends and Developments

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Weil, Gotshal & Manges LLP

Weil, Gotshal & Manges LLP was founded in 1931 and has provided legal services to the largest public companies, private equity firms and financial institutions for more than 90 years. Widely recognised by those covering the legal profession, Weil's lawyers regularly advise clients globally on their most complex litigation, corporate, restructuring, and tax and benefits matters. Weil has been a pioneer in establishing a geographic footprint that has allowed the firm to partner with clients wherever they do business. Weil's global tax department offers comprehensive knowledge of how the complex and continually evolving nature of tax law plays a crucial role in some of the most significant and high-profile domestic and cross-border transactions, restructurings and other commercial matters. The firm not only understands the nature of its clients' transactions, but also understands their businesses, and is a critical part of the team that works to accomplish each client's business goals.

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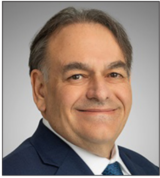

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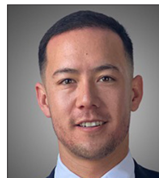

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In 2024, the United States Supreme Court (the *"Court"*) released two landmark decisions impacting on US tax law and policy. Each decision is described in further detail below.

Loper Bright Enterprises v Raimondo (*"Loper Bright"*)

In a 6-3 decision written by Chief Justice Roberts, the Court in *Loper Bright* overturned the Court's decision in Chevron v Natural Resources Defense Council, 467 US 837 (1984) (*"Chevron"*) and held that federal agency interpretations of law are not entitled to any deference (such as the deference provided to the Department of Treasury (*"Treasury"*) and the Internal Revenue Service (IRS) in the promulgation of tax regulations.

The doctrine of administrative deference, established in *Chevron*, required deference to an agency's reasonable interpretation of an ambiguous statute, so long as Congress had not spoken directly to the precise question at issue. The two-part test for requiring deference first addressed whether *"Congress had directly spoken to the precise question at issue"*. If so, the court was required to enforce the *"unambiguous express intent of Congress"*. To be deemed *"ambiguous"*, the statute must have two or more reasonable interpretations. If the statute is silent or ambiguous, part two of the test then required the court to defer to the agency's interpretation of the statute, provided such interpretation was viewed as *"reasonable"*, regardless of whether the court may have an alternative or conflicting interpretation.

By overruling what was known as *"Chevron deference"*, the Court's opinion has the potential to substantially change the administration of taxes, which may have impacts on:

- revenue collection;
- additional costs of tax administration;
- complexity and uncertainty in the promulgation of regulations; and
- more generally, questions relating to fairness and certainty for taxpayers.

Post-Chevron Effects on Tax Law

Only time will tell what impacts the Court's decision in *Loper Bright* may have on the administration of tax laws. The following are preliminary observations on some (but definitely not all) of the potential impacts stemming from the *Loper Bright* decision.

Revenue consequences

By overturning *Chevron*, courts are no longer bound to uphold IRS regulations as authoritative interpretations of ambiguous statutes. The reinterpretation and litigation of issues could trigger a generational upheaval in tax law and open the floodgates for further litigation. As such, seemingly subtle differences in statutory interpretations could have substantial effects on federal revenues. Challenges to Treasury regulations typically involve taxpayers contending that they owe less tax. Where those challenges are successful, the impact would result in a reduction in federal tax revenue. For example, profit shifting by multinationals is estimated to cost tens of billions of dollars in corporate tax revenue per year. Although taxpayers have, in recent years, been unsuccessful in their challenging of the transfer pricing regulations under Section 482, now that *Chevron* has been overruled, such outcomes could now favour taxpayers and thus reduce federal tax revenues.

General administration of tax law

The overturning of *Chevron* deference could also affect how an agency interprets a statute when it promulgates regulations for fear that a court may disagree with that interpretation (which has

the potential of propagating existing taxpayer uncertainties). With the end of *Chevron* deference, Treasury and the IRS will likely be required to bolster the *"persuasiveness"* of a regulation to align with a lower standard of deference; this will necessarily precipitate further consultation and collaboration with practitioners such that their interpretations stand up to judicial scrutiny, notwithstanding the lack of *Chevron* deference.

Increased variability in application of law

The demise of *Chevron* could cause fairness disparities for similarly situated taxpayers. Rather than speaking in one regulatory voice, the taxing authority would be disaggregated. Judges do not necessarily arrive at uniform and broadly consistent views, and taking into account technical complexities of tax law, the decisions that are reached may foment disparate outcomes. The *"frankensteined"* approach that arises as a result of judicial determinations may significantly complicate tax planning and compliance for all taxpayers. Clear, unambiguous statutes can guide tax policy without the involvement of the judicial system – even in a post-*Chevron* world. The following are several regulatory examples that may be ripe for challenge in a post-*Chevron* world:

Transfer pricing

As noted above, transfer pricing and profit shifting by multinationals may be a hotly contested area ripe for litigation – owing to Section 482's lack of regulatory delegation and sparse delineation on appropriate profit allocation methods. The question is whether Treasury and the IRS' interpretation of Section 482 will withstand the challenge under a lower level of agency deference.

Debt equity

Section 385 is designed for determining when nominal corporate debt is treated as equity for tax purposes. Prior to what the Court held in *Loper Bright*, several commentators questioned whether the delegation of regulatory authority under Section 385 was either too broad or whether the *"recast regulations"* as written dramatically exceed the statutory scope of the delegation of regulatory authority granted to Treasury. This is yet another area that is ripe for challenge in the post-*Chevron* world.

Tax Cuts and Jobs Act (TCJA) regulations

The TCJA contained many changes to US federal income tax law. For example, the TCJA:

- disallowed or scaled back a number of deductions;
- revised international tax rules;
- altered cost-recovery provisions;
- reduced the corporate tax rate; and
- allowed a pass-through deduction for certain unincorporated business.

To the extent that these provisions are ambiguous and are the subject of regulations that attempt to clarify ambiguities, *Chevron* deference would have made it easier for the Treasury to defend those regulations. In a post-*Chevron* world, the courts, rather than Treasury, will need to resolve whether the regulations seeking to clarify those statutory ambiguities pass muster under a lower level of deference.

Moore v United States (*"Moore"*)

On 20 June 2024, the Court issued its opinion in *Moore*, ruling 7-2 that the TCJA's mandatory repatriation tax (MRT) under Section 965 does not violate the *"Direct Tax Clause"* of the Constitution. Congress enacted the MRT as part of the TCJA's shift to a more territorial tax system.

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Background

The MRT required US shareholders owning 10% (by vote or value) of a controlled foreign corporation (CFC) as defined under Section 951 to pay a one-time transition tax in a deemed repatriation of realised but undistributed income of the CFC. Such income had, until the enactment of the MRT, enjoyed deferred taxation in the hands of the CFC's US shareholders (until distributed to such shareholders).

Key takeaways

In plain terms, the decision reaffirms the principle that Congress can attribute a foreign corporation's income to its US shareholders and tax them accordingly (even if the earnings relating to the income have not been distributed).

In the ruling, a majority of the Justices found that the MRT operates in a way that does not require the Court to weigh whether the Constitution's Sixteenth Amendment prohibits Congress from taxing unrealised income. In doing so, the Court sidestepped the contentious issue of whether *"realisation is required for an income tax"*. Specifically, the Court ruled that the MRT taxes income realised by foreign corporations with US shareholders, and Congress has the authority to attribute certain realised but undistributed income of certain companies to its shareholders for taxation.

The Court's ruling, however, is narrow and is limited to entities treated as *"pass-throughs"* (ie, entities that are fiscally transparent from their owners). In this respect, the Court noted that nothing in their opinion should be read as authorising any hypothetical congressional effort to tax both an entity and its shareholders (or partners) on the same undistributed income of the entity, nor does the decision attempt to resolve the parties' disagreement over whether realisation is a constitutional requirement for an income tax.

Ruling breakdown

The Moores challenged the MRT after they were assessed with a nearly USD15,000 tax bill for 2017 as a result of the law, which required them to pay the MRT based on the undistributed earnings allocable to them from an India-based CFC called KisanKraft. The Moores paid the tax and then sued for a refund, claiming, among other things, that the MRT violated the Direct Tax Clause of the US Constitution as the MRT was an unapportioned direct tax on their shares of KisanKraft stock. The District Court dismissed the suit, and the Ninth Circuit affirmed.

Taxes on income v taxes on property

Ruling: the MRT does tax realised income – income realised by the corporation, KisanKraft

The Court notes in its analysis that the ruling does not address the distinct issues that would be raised by:

- an attempt by Congress to tax both the entity and the shareholders or partners on the entity's undistributed income;
- taxes on holdings, wealth or net worth; or
- taxes on appreciation.

The Court makes a concerted effort to cite the government's brief, which explains that a hypothetical unapportioned wealth tax *"could of course raise different issues"*. The government's brief also distinguishes an income tax from a tax on wealth or net worth, as an income tax targets economic gain *"between two points of time"*. The Court notes that the constitutionality of a hypothetical unapportioned tax on appreciation may depend on (among other things) whether

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realisation is a constitutional requirement for an income tax.

The Court found that *Moores'* reliance on Eisner v Macomber, 252 US 189 (*"Macomber"*) was misplaced. In *Macomber*, the question was whether a pro rata distribution of additional common stock to all existing common shareholders was taxable income. The Court said such a distribution is not taxable income as income requires realisation. The Court further explained that there was no change in the value of the shareholders' total stock holdings in the corporation before and after the stock distribution. The Court said separately in dicta that *"what is called the stockholder's share in the accumulated profits of the company is capital, not income"*. The Moores interpreted that language to mean that a tax attributing an entity's undistributed income to its shareholders or partners is not an income tax. The Court noted in its opinion that the clear and definitive holdings of other court precedent render the *Moores* reading of *Macomber* implausible. The Court noted that those cases squarely addressed and allowed attribution, whereas *Macomber* did not address attribution.

Attribution

Ruling: Congress may attribute an entity's realised and undistributed income to the entity's shareholders or partners and then tax the shareholders or partners on their portions of that income

Instead of arguing that partnership taxes, S-corporation taxes and subpart F taxes are all unconstitutional (and that all of the Court's precedent regarding such taxes should be overruled), the Moores tried to distinguish the MRT from the other taxes and argued that that only the MRT is unconstitutional, conceding that partnership taxes, S-corporation taxes and subpart F taxes *are* income taxes that are constitutional and need not be apportioned. The Moores sought to differentiate the MRT from the other taxes by noting that:

- taxes on partnerships are distinguishable from the MRT and are not controlled by precedent as partnerships are not separate entities from their partners;
- taxes on S-corporations are distinguishable from the MRT because shareholders choose to be taxed directly on the corporation's income; and
- the pre-TCJA aspects of subpart F are distinguishable from the MRT as subpart F applies the *"doctrine of constructive realisation"* which – by targeting specific events such as a foreign corporation's earning of investment income while being controlled by a small number of domestic shareholders – allows the pre-TCJA portion of subpart F to satisfy the constructive realisation requirement.

The Court found that the Moores failed to sufficiently distinguish the MRT from the other taxing regimes – specifically, as follows.

- In response to the Moores' attempt to distinguish partnership tax from the MRT, the Court noted that when the Sixteenth Amendment was ratified, the courts, Congress and state legislatures treated partnerships as separate entities in many contexts, and numerous states imposed taxes directly on partnerships for partnership income. As such, the federal and state treatment of partnerships as separate legal entities for tax purposes contravenes the Moores' theory.
- In response to the Moores' attempt to distinguish S-corporation tax from the MRT, the Court noted that consent cannot explain Congress's authority to tax the sharehold-

ers of S-corporations directly on corporate income. Rather, S-corporations are another example of Congress's authority to either tax the corporation itself on corporate income or attribute the undistributed income to the shareholders and tax the shareholders.
- In response to the Moores' attempt to distinguish the pre-TCJA aspects of subpart F tax from the MRT, the Court noted that the level of control with the MRT (at least 10%) is the same as under the longstanding subpart F tax principles (and, thus, if the Moores concede that subpart F is not unconstitutional under the *"constructive realisation"* theory, the MRT is likewise not unconstitutional under that theory).

With *Moore* providing some semblance of stability, *Loper Bright* poses a significantly broader challenge to the stability of administrative law writ large – by no means excluding tax regulations.

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