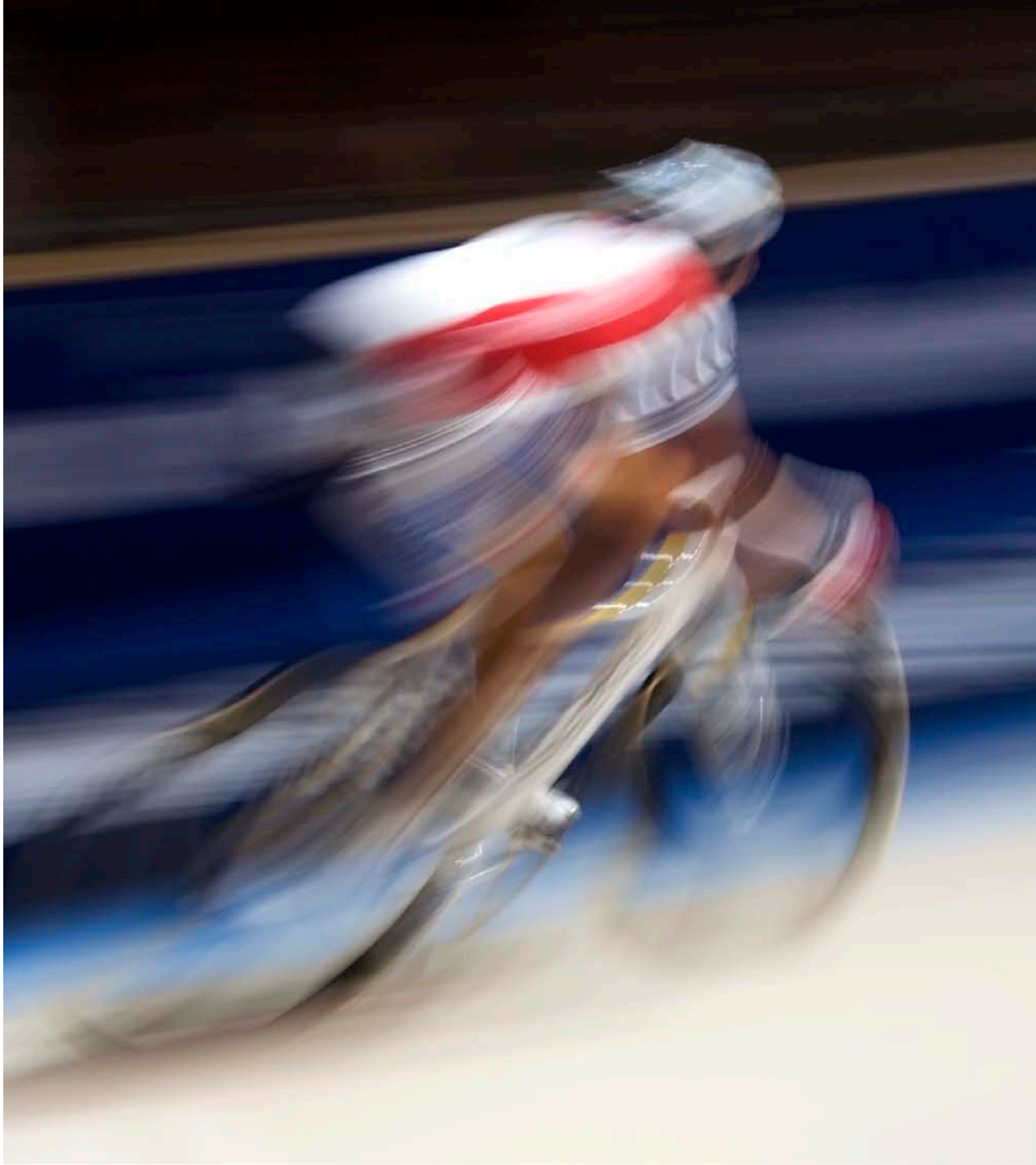
Utilization of Partnerships in International Planning



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Agenda

Discuss key elements of partnerships and how they are being used in an international context

Explore potential benefits and considerations of contributing IP to partnerships and learn the current thinking on partnership allocations

Introduction

Partnerships distinguished from other economic relationships

- Co-ownership of property
  - When a local law entity is used, section 704(e)(1) favors partnership treatment
  - When a local law entity is not used (e.g., a contractual relationship is formed), the facts and circumstances must be considered
    - In general, mere co-ownership of property should not give rise to a partnership. *See* Treas. Reg. § 301.7701-1(a)(2)
    - Co-ownership of property coupled with the provision of services, however, is likely to give rise to a partnership

Factors relevant in determining the existence of a partnership

- Joint sharing of profits/losses
- Joint management
- Joint contribution
- Joint control over income and capital
- Form
- Any other facts shedding light on the parties’ true intent

Contributions of IP to partnerships

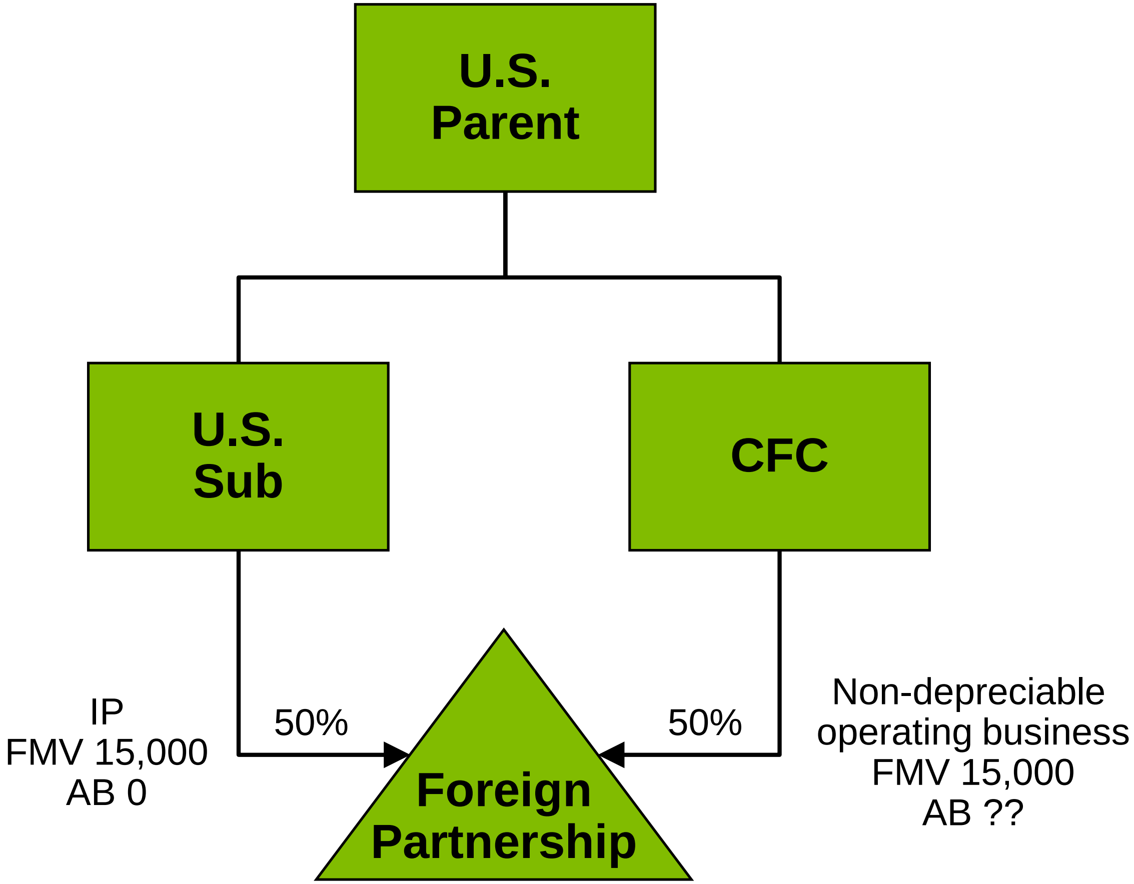
Comparing the partnership to any other form of payment

- Regardless of the form of consideration received (except in the case of certain partnership interests), a transferor is effectively selling the IP and will recognize gain on the sale as payments are received
- On a contribution to a partnership, the timing of recognition of the built-in gain in the IP depends, in part, on the section 704(c) method chosen

Comparing corporation vs. partnership equity contributions

- Transfers of IP to foreign corporations are subject to section 367(d):
  - If a U.S. person transfers any intangible property to a foreign corporation in a section 351 or 361 exchange, the U.S. person transferring such property shall be treated as—(i) having sold such property in exchange for payments that are contingent upon the productivity, use, or disposition of such property, and (ii) receiving amounts that reasonably reflect the amounts that would have been received annually in the form of such payments over the useful life of such property, or (in the case of a disposition) following such transfer (whether direct or indirect), at the time of the disposition. These amounts shall be commensurate with the income attributable to the intangible.
- Partnerships are not subject to section 367(d), but instead must comply with section 704, including 704(c); regulations authorized by section 367(d)(3)/721(d) have never been issued
  - Instead, the partner will be required to recognize any built-in gain in the IP either throughout the life of the IP (depending on whether it is amortizable and the section 704(c) method chosen) or upon the earlier of the partnership's disposition of the IP or the partner's disposition of its partnership interest.

Outbound IP contribution



Transfers of IP: Comparison of payment options

	Sale to a foreign entity	License to a foreign entity	Contribution to a foreign corporation	Contribution to a foreign partnership
Transaction description	Sell substantially all rights in IP. Payment may be structured as a payment up front or over time (e.g., level payment or declining payment)	License less than substantially all IP rights to a foreign subsidiary in exchange for a fee - contingent upon the productivity, use or disposition of the intangible	Contribute IP rights to a foreign subsidiary classified as a corporation for U.S. federal income tax purposes	Contribute IP rights to a foreign subsidiary classified as a partnership for U.S. federal income tax purposes
Computation of return and income inclusion	Sale price is equal to the value of the IP determined under section 482 with immediate income inclusion determined by reference to FMV and adjusted tax basis. Consider installment method	Royalty paid (and included in income) over a predetermined period determined under section 482	Deemed royalty included in income over useful life of the IP (not to exceed 20 years) determined under sections 367(d) and 482	Equity-based return (with potential cap on future appreciation) determined under sections 704(b) and 482 by reference to the relative FMV of the IP contributed

Transfers of IP: Comparison of payment options (cont'd)

	Sale to a foreign entity	License to a foreign entity	Contribution to a foreign corporation	Contribution to a foreign partnership
Relative level of complexity	Low	Medium	Medium	Medium to High
Key drivers	• Location of IP (U.S. vs. Non-U.S. seller) • Attributes of seller, i.e. NOLs, FTC, etc. • Source of income. • Desire to migrate U.S. vs. foreign rights • IP FMV = consideration • Definition of a sale (GAAP) vs. License (Tax) • GAAP accounting. • FTC planning.	• Location of IP (U.S. vs. Non-U.S. seller) • QCSA vs. Non-Qualified CSA • Useful life of IP • Treatment of goodwill/going concern value • Desire to migrate U.S. vs. foreign rights • Attributes of seller	• Location of IP (U.S. vs. Non-U.S. seller) • Value of the IP • Attributes of seller • Useful life of IP • Treatment of goodwill/going concern value • Desire to migrate U.S. vs. foreign rights • GAAP accounting	• Location of IP (U.S. vs. Non-U.S. seller) • Foreign tax profile of partnership • Attributes of seller • Operations of partnership • Current value of IP • Equity vs. royalty-based return

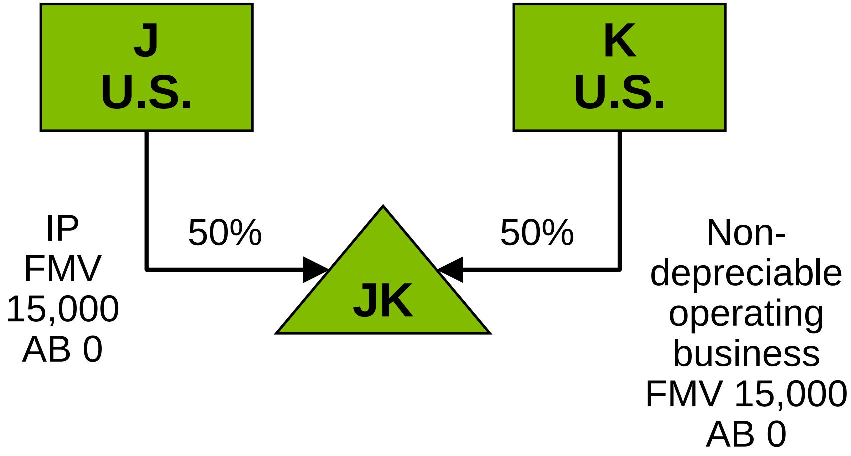
Key drivers in transferring IP to a partnership

	Non-U.S. operations	Non-amortizable U.S. IP	Foreign tax credits	Character of preferred return	U.S. GAAP treatment
Considerations	Sufficient cash flow producing assets in the partnership	Greatest opportunity for U.S. tax deferral	Foreign tax credits available to shelter U.S. taxable income recognized on preferred return.	Preferred Return should be structured to ensure it is foreign source general limitation	Ability to defer deferred tax liability attributable to built in gain in IP
Importance to inbound planning	High	High	High	Dependent on facts	Dependent on facts
Importance to outbound planning	High	High	Medium	Dependent on facts	High

Section 704(c) in the international context

In general

Section 704(c) example



- J (U.S.) contributes intellectual property ("IP") with a value of 15,000 and an adjusted basis of 0
- K (CFC) a non-depreciable operating business with contributes a value of 15,000 and a basis of 15,000
- Revenues exceed expenses by 1,000 a year
- In each year, the IP generates 1,000 of book depreciation and 0 of tax depreciation
- The parties anticipate the royalty income will have substantially the same effect on their tax liabilities as income from J's contributed IP
- The IP is sold at the end of year 15 for 15,000
- At the end of year 15, the fair market values of each of J's and K's interests in JK are 22,500

Traditional method

- Limited by the "ceiling rule:" There is a ceiling rule limitation when the partnership has not recognized enough tax items to match book allocations to the non-contributing partner

	J		K	
	Book	Tax	Book	Tax
Beginning	15,000	0	15,000	15,000
15 Years of amortization	(7,500)	0	(7,500)	0
15 Years of income	7,500	7,500	7,500	7,500
Sale in Year 15	7,500	7,500	7,500	7,500
Ending	22,500	15,000	22,500	30,000

- (7,500) of built-in-loss remains in K's JK interest
- J recognized 15,000 of income for U.S. federal income tax purposes
- 7,500 of built-in-gain remains in J's JK interest

Traditional method with curative allocations – currently

- The curative method attempts to “cure” the ceiling rule limitation by allocating other similar tax expense items away from the contributing partner and to the non-contributing partner or allocating similar tax income items away from the noncontributing partner to the contributing partner.

	J		K	
	Book	**Tax**	**Book**	**Tax**
Beginning	15,000	0	15,000	15,000
15 Years of amortization	(7,500)	0	(7,500)	0
15 Years of income	7,500	15,000	7,500	0
Sale in Year 15	7,500	7,500	7,500	7,500
Ending	22,500	22,500	22,500	22,500

- Recognized 22,500 of income for U.S. federal income tax purposes, 7,500 of which resulted from curative allocations of income
- What if JK did not have 1,000 of income each year?

Remedial method

- The remedial method cures the ceiling rule limitation by creating notional tax items for both the contributing and non-contributing partners

	J		K	
	Book	**Tax**	**Book**	**Tax**
Beginning	15,000	0	15,000	15,000
15 Years of amortization	(7,500)	0	(7,500)	0
15 Years of remedial allocations	0	7,500	0	(7,500)
15 Years of income	7,500	7,500	7,500	7,500
Sale in Year 15	7,500	7,500	7,500	7,500
Ending	22,500	22,500	22,500	22,500

- J recognized 22,500 of income for U.S. federal income tax purposes, 7,500 of which came from remedial allocations of income.

Current thinking

- The IRS cannot force a taxpayer to use the Remedial Method
- Curing ceiling rule limitations with gain on the disposition of ceiling rule limited property
  - Treas. Reg. § 1.704-3(c)(3)(i) provides that a curative allocation is not reasonable to the extent it exceeds the amount necessary to offset the effect of the ceiling rule for the current taxable year, or in the case of a curative allocation upon disposition of the property, for prior taxable years.
  - Must the cure with gain on disposition be with gain from the sale of the property that gave rise to the ceiling rule limitation or may it be from other property?
    - Curative allocations must be expected to have substantially the same effect on each partner's tax liability as the tax item limited by the ceiling rule under Treas. Reg. § 1.704-3(c)(3)(iii)(A)
    - Curative allocations with gain from the sale of the property that gave rise to the ceiling rule are exempt from the character requirement under Treas. Reg. § 1.704-3(c)(3)(iii)(B)

Current thinking

- Curing ceiling rule limitations with gain on the disposition of ceiling rule limited property; (cont'd)
  - Treas. Reg. § 1.704-3(c)(3)(ii) provides that a partnership may make curative allocations in a taxable year to offset a prior year ceiling rule limitation if the allocations are made over a reasonable period of time such as over the property's economic life and are provided for under the partnership agreement in effect for the year of the contribution
    - May mean the property's remaining tax recovery period, remaining economic life, or both if the two are the same
    - Curative allocations made pursuant to this rule should be spread ratably over a reasonable period

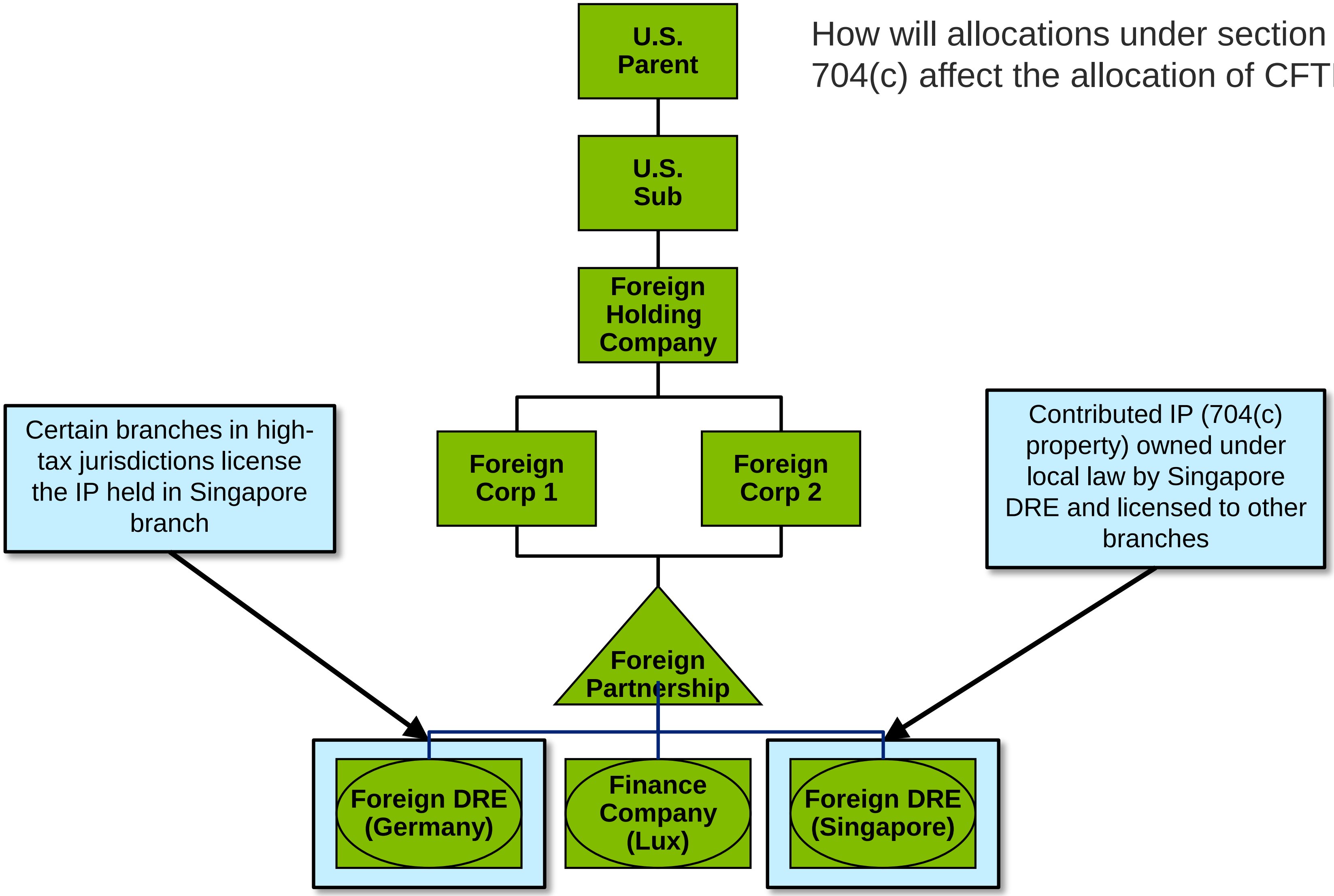
Allocation of foreign taxes

Allocations of CFTEs and Section 704(c)

- Allocations of Creditable Foreign Tax Expenditures (“CFTEs”) do not have Substantial Economic Substance (“SEE”) and therefore, must be allocated in accordance with the Partner’s Interest in the Partnership (“PIP”)
- Safe harbor – an allocation of CFTE is deemed to be in accordance with PIP if
  - (1) the CFTE is allocated (whether or not pursuant to an express provision in the partnership agreement) and reported on the partnership return in proportion to the distributive shares of income to which the CFTE relates
  - (2) allocations of all other partnership items that materially affect the CFTEs allocated to a partner are valid. (Treas. Reg. § 1.704-1(b)(4)(viii)(a))
- A partner’s distributive share for purposes of this safe harbor is the partner’s distributive share of taxable income (not section 704(b) book income), and is calculated by taking section 704(c) into account

Geographic allocations revisited

How will allocations under section 704(c) affect the allocation of CFTEs?



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Speaker bios

Jenny Alexander recently rejoined the Passthroughs group in the National Tax Office of Deloitte Tax LLP as Co-Managing Principal, where she specializes in the use of partnerships and limited liability companies in domestic and cross-border mergers and acquisitions, financing transactions, and restructurings.

Prior to returning to Deloitte, Jennifer served in the Office of Tax Legislative Counsel at the U.S. Department of the Treasury as an Attorney Advisor.

Jennifer has authored articles that have appeared in numerous professional publications, including Tax Notes, Journal of Taxation, TAXES, and Tax Planning for Domestic & Foreign Partnerships, LLCs, Joint Ventures, & Other Strategic Alliances (Practicing Law Institute). Jennifer is a frequent lecturer on a variety of topics dealing with U.S. federal income taxation, having spoken at many of the country's leading tax conferences, including the Practising Law Institute, the Southern Federal Tax Institute, the New York University's Institute on Federal Taxation and Summer Institute on Federal Taxation, the American Bar Association Tax Section, and the Tax Executives Institute.

Jennifer received her B.A. in Government and Politics from the University of Maryland, and her J.D. from the Georgetown University Law Center. Jennifer is a member of the American Bar Tax Section, a member of the Tax Section's Committee on Partnerships and LLCs, and former CLE Chair for the committee. In 2006, she was the recipient of the American Bar Association Tax Section's John Nolan Fellowship. She is a member of the State Bar of Maryland and is admitted to practice in Maryland.

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Philippe Penelle is a Principal specializing in Global Value Alignment (GVA) strategies and transfer pricing solutions for some of the firm's largest multinational companies. As the National Co-Leader of Deloitte Tax LLP's GVA group, and its Midwest Regional Transfer Pricing Leader, Philippe leads a group of dedicated international tax and transfer pricing specialists in designing and implementing complex strategies. The group also assists multinational companies in structuring their value chain functions (not limited to supply chain) and intellectual property holdings in a tax and treasury efficient manner. With over a decade of experience in the valuation of intellectual property for transfer pricing purposes, Philippe has not only assisted his clients in developing and implementing efficient tax structures, he has also represented them in front of the Internal Revenue Service in Advance Pricing Agreement proceedings and in audit defenses.

Prior to joining Deloitte Philippe was an Assistant Professor at the University of Chicago where he also received his Ph.D. in Economics. Philippe is fluent in French and English.

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Speaker bios

Chris Trump is a Principal in the International Tax Service Line in Deloitte Tax LLP's Washington National Tax Office. He provides services to multinational companies in a variety of industries specializing in mergers and acquisitions, foreign tax credit planning, financing transactions, repatriation, and the utilization of partnerships in cross-border transactions. In addition, he regularly advises clients on issues involving foreign currency, loss surrender and utilization, and the design and implementation of principal company structures.

Prior to joining Deloitte, Chris was the Assistant to the Branch Chief, Branch 4, in the Office of the Associate Chief Counsel (International) for the Internal Revenue Service. Chris also worked in the Office of the Associate Chief Counsel (Passthroughs and Special Industries). He is a frequent speaker and is the author of numerous articles on tax planning for U.S.-based multinational corporations.

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