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KPMG's U.S. Japanese Practice

JNET NEWSLETTER

U.S. business update for Japanese companies

Issue 3 – 2014
ENGLISH EDITION

Contents

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Transfer Pricing Audit Roadmap: An Overview

On February 14, 2014, the Transfer Pricing Operations office of the Internal Revenue Service (IRS) released the Transfer Pricing Audit Roadmap (the Roadmap). The Roadmap is intended to provide IRS exam teams with the tools and guidance necessary to identify early in the examination those transfer pricing issues that merit pursuing, and then to assist the teams in developing more defensible adjustments. The Roadmap also provides taxpayers with insight into what they can expect during transfer pricing examinations. This article identifies the key themes of the Roadmap, summarizes the proposed phases of the transfer pricing audit, and considers ways in which taxpayers can use it to prepare for transfer pricing audits.

Key Roadmap concepts:

The Roadmap sets forth the following four key concepts:

- Up-front planning is essential.
- Transfer pricing cases are usually won or lost on the facts.
- The objective in a transfer pricing audit is to determine a reasonable result under the facts and circumstances of any given case.
- Effective presentation can make or break a case.

Additionally, under the Roadmap, transfer pricing audits should be conducted with increased transparency. Exam teams also are encouraged to involve experts within the IRS to provide guidance and assistance, as appropriate, during the exam.

Audit phases:

While not mandating a two-year cycle for all transfer pricing examinations, the Roadmap suggests that complex transfer pricing issues may typically take 24 months to resolve, with the cycle consisting of three discrete phases: (1) planning (months 1 through 6), (2) execution (months 3 through 17), and (3) resolution (months 18 through 24).

Phase 1: Planning

- Pre-exam analysis (months 1–2)
- Opening conference and transfer pricing orientation (months 1–6)
- Preparing initial risk analysis, exam plan, and key milestones (months 3–6)

In the planning phase, IRS examiners develop a working hypothesis of the case and perform an initial risk assessment, which should be shared with the taxpayer. Developing the initial risk assessment is fundamental to the audit process under the Roadmap; before proceeding with a potentially protracted examination, agents must first determine whether a case is worth pursuing. Because transfer pricing cases are generally "won or lost on the facts," the Roadmap encourages examiners to focus on the facts and economics of intercompany transactions—as opposed to legal interpretation of the Regulations—and to develop what it refers to as an "effective story" early in the exam to explain the taxpayer's value chain, competitive position in the industry, and financial results. "If indications are that the tax result claimed by the taxpayer is at odds with common sense and economic reality—'too good to be true'—chances are it is a good candidate for further scrutiny," according to the Roadmap. Conversely, if the economics are reasonable, the case may not be worth pursuing. The IRS believes by narrowing the audit focus to those cases in which it has a chance of prevailing, it will better

conserve its resources.

Also notable, in this phase—and all other phases—the Roadmap instructs examiners to document the process by which they develop facts and create (and later adjust) their hypotheses. It is the IRS's hope that increased documentation will support adjustments later on should the taxpayer choose to go to IRS Appeals or to litigate.

Phase 2: Execution

- Fact finding and additional information document requests, functional analysis (months 3–17)
- Mid-cycle risk assessment (months 7–17, target month 12)
- Issue development and preliminary reports (months 16–18)

During this phase, IRS examiners continue to develop the facts and perform economic analyses, including comparability and functional analysis of the relevant transactions. This entails reviewing accounting data and identifying economically significant activities performed in connection with such transactions.[1] Based upon the fact finding and analyses performed during the execution phase, examiners are expected to narrow the focus of the examination by determining which, if any, transactions need further scrutiny. An examiner will then draft a preliminary statement of the facts to provide to taxpayers for feedback, along with a preliminary economic report critiquing the taxpayer's chosen method, tested party, comparables, etc.

Phase 3: Resolution

- Pre-notice of proposed adjustment (NOPA) issue presentation (months 18–19)
- Resolution discussions (months 19–22)
- Final NOPA and case closing (months 20–24)

During this phase, IRS examiners finalize their analysis and propose adjustments. Before issuing a final NOPA, however, examiners are instructed to meet with the taxpayers and to assess the risks of moving forward.

How to prepare for transfer pricing examinations:

The IRS believes that early risk assessment by an examiner during the planning phase should lead to fewer lengthy examinations that would ultimately result only in nominal adjustments, if any. This will conserve resources of both the IRS and the taxpayer. Furthermore, the Roadmap should lead to a more transparent application of transfer pricing rules and more consistent examination outcomes.

Taxpayers should familiarize themselves with the Roadmap to assess its possible effect on transfer pricing examinations. Up-front planning works both ways, and prepared taxpayers who are able to readily substantiate the arm's-length nature of their intercompany transactions arc more likely to see their examinations concluded in the planning phase. To that end, taxpayers should consider conducting their own risk analysis before an examination begins:

1. Know the company's facts and make sure that its transfer pricing documentation, intercompany agreements, financial data, and other relevant documents and data are consistent. If deficiencies are identified early, they can be addressed in advance of the audit.
2. Know the company's facts and make sure that its transfer pricing documentation, intercompany agreements, financial data, and other relevant documents and data are consistent. If deficiencies are identified early, they can be addressed in advance of the audit.
3. Keep relevant economic, legal, and financial data, including transfer pricing studies and other analyses, organized and readily available for when the examination begins.
4. Be prepared to tell the taxpayer's compelling story, explaining what drives the business in terms of functions, risks, and assets. Taxpayers need to know their value chain and be able to explain it clearly during the risk assessment process.

Once the audit begins, taxpayers can strategically invoke the Roadmap to enhance the examination process. For example, the Roadmap recommends increased transparency of the process, with the exam team providing certain documents, such as the risk assessment and draft statement of facts, to the taxpayer for feedback. Taxpayers should request that they do so. Also, the Roadmap suggests that the exam team involve—sooner rather later—other IRS transfer pricing experts to improve audit processes. A taxpayer may also benefit

[1] To facilitate an IRS agent's ability to gather information in a timely manner, the Roadmap refers to the IRS's new IDR response policy three separate times, thereby underscoring its importance to transfer pricing examinations. See Dolan, Michael P., "IRS Changes Document Requests and Appeals Rules for Large Taxpayers," KPMG TAX DISPUTE RESOLUTION QUARTERLY, Issue No. 7 (Summer 2013).

from this approach and should consider, for example, requesting involvement from the Advance Pricing and Mutual Agreement Program when an adjustment may be raised that would require competent authority assistance. In addition, the Roadmap provides that agents should involve chief counsel early and often, and taxpayers too should consider requesting the involvement of chief counsel when the issues or the process becomes more complex than originally anticipated.

The IRS believes that applying the Roadmap should result in more efficient and standardized transfer pricing examinations. Additionally, early risk assessment can allow the IRS to dispose of cases that it is not likely to win early in the process. Taxpayers that are familiar with the goals and objectives of the Roadmap will be better prepared to navigate future audits.

Questions?

If you have any questions about this article please reach out to your KPMG engagement team or the contacts listed with this article.

Hiding in Plain Sight: The Anatomy of a Bribe

TODAY'S REALITY

- Operating in foreign countries carries the risk of bribery and corruption.
- Bribes can lurk anywhere that there is contact with foreign officials.
- Bribes are most often camouflaged as legitimate payments.
- There are many types of bribes, and they can live in both the supply and sales channels.

Enforcement of anti-bribery and corruption laws around the world is at an all-time high. Regulators are attacking corruption by wielding older weapons, such as the 1977 U.S. Foreign Corrupt Practices Act (FCPA), and by using new ammunition like the 2010 U.K. Bribery Act.

If your company does business in any foreign country, there's a risk that bribes could be hiding in plain sight. To know what they look like and where to find them, you first need to understand the anatomy of a bribe.

What Is a Bribe?

The dictionary defines a "bribe" as " money or favor given or promised in order to influence the judgment or conduct of a person in a position of trust." Yet its meaning under most global anti-bribery and corruption laws is much more nuanced.

Example: The FCPA prohibits paying, offering, or promising to pay "anything of value" to a foreign government official or instrumentality in order to obtain or retain business. There's no minimum monetary threshold. Whatever is paid or promised can have an intangible value, and it can be received only beneficially by the recipient.

A bribe also must be intended to corruptly induce the recipient to misuse an official position. The U.K. Bribery Act defines a bribe as being a "financial or other advantage" and does not require corrupt intent. The Anti-Bribery Convention of the Organization for Economic Cooperation and Development, which has been signed by 39 countries, defines a bribe as any " undue pecuniary or other advantage" that was made intentionally.

What Are the Exceptions?

Under the FCPA, payments that otherwise would be bribes cases that were not generally accepted in aren't prohibited if they are made to facilitate or expedite routine governmental actions, such as issuing permits or licenses. A payment or promise that would constitute a bribe under the FCPA also isn't prohibited if it is legal under the written laws of the applicable foreign country.

Most anti-bribery and corruption laws permit payments to foreign government officials for bona fide hospitality, promotion, product demonstration, and other business expenditures that are proportionate and reasonable.

On the Trail of Bribes

Periodic proactive risk assessments should be conducted to pinpoint areas where the business may be most vulnerable. Armed with this risk profile, internal controls can be implemented strategically and testing can be aimed precisely. Bribes most often are camouflaged as legitimate payments. They may take cover in both the supply channel and the sales channel, and they may be propagated by third parties.

Look for foreign government contacts with your organization. These may be direct contacts, such as interacting with government agencies that regulate business licenses, taxes (VAT), customs, import/export, real estate, transportation/ shipping, utilities, and product certifications or approvals. Foreign government contacts

also occur indirectly through third-party intermediaries. Closely monitor those that carry the greatest risk: brokers, agents, shippers, custom logistics, resellers, and distributors delivering services that interact with foreign officials.

Sufficient background research needs to be conducted on vendors, suppliers, and agents to ensure that you are dealing only with reputable third parties. You must determine if any third parties are owned or controlled by current or former foreign officials, or by people closely affiliated with these officials. Sophisticated corporate intelligence tools can provide various levels of reputational due diligence.

Where Do Bribes Hide?

Look for insufficient or nonexistent descriptions of the transaction, lack of proper support, and specious business rationale for the transaction. Conducting trend analyses and data analytics on these accounts can expose anomalies that might point to a hiding place. Taking a risk-based judgmental sample of transactions for testing can be based on certain risk factors (e.g., the kind of counterparties, the geographical location of counterparties, the stated purpose of the transaction, and the likelihood of government touch points).

Many bribes are relatively small in amount. It may be necessary to take samples of transactions and review supporting documentation to assess the legitimacy of a payment.

With travel and entertainment expenses, look for original receipt documentation; the names of individuals involved and the purpose of the event; proper approvals and timely submissions; reasonable exchange rates; and mathematical accuracy of the expense report.

Each document transmitted to or from your organization should be examined for a bribe's footprint. Bribes may hide in contracts and agreements, financing arrangements, invoices, purchase orders, bills of lading and shipping documents, bank statements, and written communications. Special attention should be paid to supplemental, modified, or last-issued invoices and purchase orders because many times a bribe is solicited after the initial business dealings. Sales contracts should be reviewed to assess the reasonableness of margins, commissions, and costs, as well as for vague terms, advance fees, large termination fees, or frequent undocumented change orders.

The most common types of disguises are special payments or fees; above-market commissions; business introduction fees; rebates or discounts; promotion and marketing expenses; inspection fees; political or charitable contributions; or unusual selling or distribution charges. More creative covers for bribes can be manipulations of currency exchange conversions; payments in other currencies; overstated product quantities or weights; overly complex financing terms; or unnecessary insurance/ indemnity charges.

Simplifying the supply and sales channels can help. Many of the hiding places can be removed by eliminating third parties that aren't essential for business operation, by reducing complex procurement and distribution processes, and by creating uniform external documentation.

Identifying Bribes That Leave No Trace on the Books and Records

Preferential treatment or manipulation in the bidding or RFP process to select suppliers, vendors, or third-party agents can also be a breeding ground for bribes that rarely leave a trail.

Additionally, bribes may take the form of:

- Gifts
- Use of materials, equipment, facilities, or services
- Transportation and hospitality
- Offers of employment
- Scholarships and educational allowances

Another form of bribery is awarding work to a third party that's affiliated with a current or former foreign official or their family. This is especially true if the third party isn't qualified, can't deliver the service, or doesn't submit the lowest bid or quote. These types of bribes are extremely difficult to detect because they often don't leave a footprint anywhere in your organization. In many cases, the only way to detect one of these bribes is for someone to spot it and report it to the appropriate person.

What Can I Do Now?

Armed with understanding of what bribes are and where to look for them, the most effective way to ferret out bribes then becomes implementation of a comprehensive anti-bribery and corruption compliance program. But one size does not fit all. A compliance program must be tailored to accommodate your risk profile and resources.

By taking a proactive approach to preventing bribery, you can dramatically reduce the occurrence of bribery even in the most corrupt locations. Because bribes can live in so many different habitats, a comprehensive compliance program is like a net that can snare bribes wherever they hide...even in plain sight.

Questions?

If you have any questions about this article please reach out to your KPMG engagement team or email us at us-kpmg-jp@kpmg.com.

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Auditing & Accounting Update

In this section, we provide brief updates on regulatory developments in auditing and accounting that may impact Japanese companies in the United States. Further discussion of the issues can be found in KPMG's Department of Professional Practice's **Defining Issues** http://search.kpmginstitutes.com/?bigi=1&q=Defining+Issues&x=0&y=0

SEC Discusses Conflict Minerals Rule and Court Ruling

The SEC Division of Corporation Finance released a statement that provides guidance about the SEC staff's expectations for companies that must comply with the Conflict Minerals Rule. Despite the U.S. Court of Appeals ruling in April 2014 that a portion of the Rule violated the First Amendment, companies will still need to comply with most of the disclosure requirements in the Rule. However, an independent private sector audit is required only if a company voluntarily elects to describe its products as DRC conflict free in its Conflict Minerals Report.

Go to Defining Issues 14-22 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/di-14-22-conflict-minerals.pdf

FASB Continues Discussions on Classification and Measurement of Financial Instruments

In the FASB meeting on May 14, 2014, the Board continued redeliberations on its proposed standard about financial instrument classification and measurement, and discussed equity investments, the valuation allowance on deferred tax assets related to debt securities classified as available-for-sale, and other issues.

Go to Defining Issues 14-23 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/defining-issues-14-23-financial-instruments.pdf

Revenue from Contracts with Customers

On May 28, 2014, the FASB and IASB issued their joint revenue recognition standard. The core principle of the standard is that an "entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services." The standard provides a five-step model and application guidance to determine when and how revenue is recognized:

Step 1: Identify the contract with a customer;

Step 2: Identify performance obligations in the contract;

Step 3: Determine the transaction price;

Step 4: Allocate the transaction price to performance obligations; and

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The standard will replace most existing revenue recognition guidance in U.S. GAAP and IFRS.

Go to Defining Issues 14-25 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/defining-issues-14-25-revenue-contracts-customers.pdf

FASB Makes Decisions on Presentation and Disclosures for Financial Instruments

In the FASB meeting on June 4, 2014, the FASB continued redeliberations about its proposed standard on financial instrument classification and measurement. Specifically, the Board discussed presentation and disclosure requirements for financial instruments.

Go to Defining Issues 14-26 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/defining-issues-14-26-presentation-disclosure.pdf

EITF Reaches Two Final Consensuses

In the meeting on June 12, 2014, the FASB's Emerging Issues Task Force discussed three issues and reached a final Consensus on Issue 13-F, *Accounting for the Effect of a Federal Housing Administration Guarantee, and Issue 12-G, Measuring the Financial Assets and Financial Liabilities of a Consolidated Collateralized Financing Entity*.

The EITF also discussed Issue 13-G, *Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity*.

Go to Defining Issues 14-27 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/di-14-27-eitf-two-consensuses.pdf

Financial Instruments: Changes to Financial Assets Impairment, Classification and Measurement

In the FASB meeting on June 11, 2014, the FASB reached tentative decisions about the cost basis of loans transferred to the held-for-sale classification, certain debt securities identified for sale, and certain beneficial interests in securitized financial assets. The FASB also addressed disclosures at that meeting, and decided on the fair value measurement disclosure requirements for financial assets measured at amortized cost and equity investments that do not have readily determinable fair values.

Go to Defining Issues 14-28 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/di-14-28-financial-instruments-redeliberations.pdf

FASB and IASB Continue Discussions on Lease Accounting

The FASB and IASB continued redeliberations during the second quarter of 2014 about their 2013 Exposure Drafts on lease accounting. The Boards discussed the definition of a lease, initial direct costs, the discount rate, variable lease payments, arrangements with lease and non-lease components, contract combinations, lease modifications, subleases, and lessee balance sheet and cash flow presentation. While they agreed on many aspects of lease accounting, the Boards disagreed about when lessees would reassess variable lease payments and how a sublessor would determine the classification of a sublease.

Go to Defining Issues 14-29 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/di-14-29-fasb-iasb-lease.pdf

FASB Removes Cumulative Financial Reporting for Development Stage Entities

In June 2014, the FASB issued ASU No. 2014-10, *Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation,* which eliminates the cumulative financial reporting requirement for both public and private development stage entities (DSEs). The ASU removes the definition of a DSE from the glossary of the *FASB Accounting Standards Codification®* thereby eliminating all references to DSEs and the resulting disclosures in financial statements about the cumulative amounts of income, cash flows, and shareholder's equity.

The ASU also expands the disclosure requirements in FASB ASC Topic 275, Risks and Uncertainties, about an entity's activities where planned operations have not commenced, and removes requirements that are specific to a DSE in evaluating whether an entity is a variable interest entity. There is an option for early adoption of ASU 2014-10 for financial statements not yet issued.

Go to Defining Issues 14-30 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/defining-issues-14-30-dse.pdf

FASB ASU 2014-10 >
http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176164115018

FASB Changes Accounting for Repos-to-maturity and Repurchase Financings

In June 2014, the FASB issued ASU No. 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures, which changes the accounting for repurchase-to-maturity transactions (repos-to-maturity) and enhances the required disclosures for repurchase agreements and other similar transactions (repos). Repos-to-maturity and the repurchase financings will be accounted for as secured borrowings. In addition, the standard requires new disclosures for repos.

Go to Defining Issues 14-31 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/defining-issues-14-31-repos-to-maturity.pdf

FASB Issues Two Exposure Drafts for Simplification Initiative

On July 15, 2014, the FASB issued two Exposure Drafts as part of its initiative to reduce unnecessary complexity in GAAP. The proposed ASU about inventory measurement would change the measurement principle from lower of cost or market to the lower of cost and net realizable value. The proposed ASU about income statement presentation would eliminate the concept of extraordinary items from U.S. GAAP.

Go to Defining Issues 14-32 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/defining-issues-14-32-simplification-eds.pdf

Revenue Transition Resource Group Holds First Meeting

The FASB and IASB's Joint Transition Resource Group for Revenue Recognition (TRG) met for the first time on July 18, 2014, and discussed four issues related to the new revenue recognition standard:

- Gross versus net revenue for sale of goods and services in a virtual environment;
- Gross versus net revenue for amounts billed to customers;
- Application of the sales-based and usage-based royalties exception for contracts containing licenses of intellectual property and other goods or services; and
- Impairment testing of capitalized contract costs.

TRG members offered a range of perspectives on the issues discussed but were not asked to vote or conclude on specific views or fact patterns.

At a future meeting, the FASB and IASB will consider whether the issues discussed require standard setting or further discussion. The Boards stated that standard setting should be expected in only limited circumstances.

Go to Defining Issues 14-33 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/defining-issues-14-33-revenue-transition-group.pdf

FASB Agrees to Issue New Consolidation Guidance

At its July 16 meeting, the FASB voted to issue a new consolidation standard that would change the way reporting enterprises evaluate whether (a) they should consolidate limited partnerships and similar entities, (b) fees paid to a decision maker or service provider are variable interests in a variable interest entity (VIE), and (c) variable interests in a VIE held by related parties of the reporting enterprise require the reporting enterprise to consolidate the VIE. The Board decided to exclude from the U.S. GAAP consolidation requirements money market funds that are required to comply with Rule 2a-7 of the Investment Company Act of 1940 or that operate under requirements similar to those in Rule 2a-7.

This edition of Defining Issues summarizes KPMG's current understanding of the Board's decisions, which is subject to change depending on the specific amendments to the FASB Accounting Standards Codification® in the final standard.

Go to Defining Issues 14-34 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2014/defining-issues-14-34-consolidation.pdf

Questions?

If you have any questions about this article please reach out to your KPMG engagement team or the contact listed with this article.

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Tax Update

In this section of Jnet, we provide brief updates on legislative, judicial, and administrative developments in tax that may impact Japanese companies operating in the United States.

July 2014

Old W-8 Forms May Be Used Until December 31, 2014

On July 7, the IRS has posted updated versions of the forms relating to withholding and FATCA reporting including Forms W-8IMY, W-8EXP, W-8ECI, and W-8BEN-E, noting that a withholding agent can accept the prior version of the form (i.e., the 2006 version) through the end of 2014.

Treasury regulations provide that the new forms must be used six months after the revision date (September 1, 2014 for the Form W-BEN-E and the Form W-8ECI and November 1, 2014 for the other two forms). However, the IRS had informally stated that it would allow such treatment, and the updated forms apparently are intended to provide a greater degree of comfort for withholding agents and foreign financial institutions (FFIs).

The language included in the notes on page one of each form makes clear that the 2006 version of the form obtained between now and the end 2014 will be valid for the normal validity period for purposes of withholding and until the end of the transition period for purposes of FATCA (i.e., December 31, 2014 for a "prima facia FFI" and June 30, 2016, for all other entities).

Final Regulations: Truncated TINs Allowed on Payee Statements, Other Documents

On July 14, the Treasury Department and IRS released final regulations (T.D. 9675) concerning the use of a "truncated taxpayer identification number" (TTIN), displaying only the last four digits of a taxpayer identifying number with either asterisks (*) or with Xs replacing the first five digits of the identifying number, in an effort to reduce the risk of identity theft when a taxpayer's entire identification number is used on payee statements or other documents (generally including a Schedule K-1 issued to a partner, S corporation shareholder, or trust beneficiary).

The final regulations adopt rules that were proposed in 2013 with certain changes. In general, the final regulations provide that when not prohibited by the Code, regulations or IRS guidance, a TTIN can be used on payee statements and certain other documents in lieu of:

- A taxpayer's social security number (SSN)
- IRS individual taxpayer identification number (ITIN)
- IRS adoption taxpayer identification number (ATIN)
- Employer identification number (EIN)

Under the 2013 proposed regulations, the use of a TTIN was permitted only if affirmatively authorized by the IRS. The preamble to the final regulations explains that a "modified approach" is being adopted to allow the use of a TTIN on any federal tax-related payee statement unless specifically prohibited so that there is no need to amend every information reporting regulation to permit the use of a TTIN.

The use of a TTIN, however, is not allowed on every document—e.g., tax returns and statements filed with the IRS—because complete taxpayer

identifying numbers on returns and statements filed with the IRS are necessary for the IRS to determine compliance with the tax laws and validate the information provided.

The final regulations will be published in the Federal Register on July 15 and generally are effective for payee statements due after December 31, 2014.

Delaware: Unclaimed Property Voluntary Disclosure Program Extended

Delaware's Unclaimed Property Voluntary Disclosure Agreement (VDA) program, that was originally established in 2012, has been extended. Originally, the deadline for applying to participate in the VDA program was June 30, 2014. Legislation (Senate Bill 228) provides additional time under the program by:

- Extending the deadline to enter into the VDA program to September 30, 2014
- Extending the sunset date of the program from July 1, 2015, to July 1, 2016

Companies that have received an audit notice from the Delaware State Escheator, however, cannot participate in the VDA program.

The legislation also revises the penalty and interest provisions as applied to holders of Delaware unclaimed property that fail to remit property in a timely manner. Previously, holders of unclaimed property that fail to file an unclaimed property report are subject to a penalty equal to 5% per month of the amount required to be shown on the report. The maximum penalty cannot exceed 50% in the aggregate. Interest charges could also equal up to 50% of the amount required to be reported. Under the new legislation (Senate Bill 228):

- The revised penalty for failing to file an unclaimed property report is the lower of 5% per month or $100 per day.
- The maximum penalty that can be imposed is 50% of the amount required to be shown on the report—not to exceed $5,000.
- The assessment of interest on the amount of a holder's outstanding unreported unclaimed property is repealed.

Senate Bill 228 does not indicate an effective date for the revised penalty and interest provisions.

New Jersey: Click-Through Nexus Legislation Enacted

Assembly Bill 3486 is enacted to introduce a click-through nexus statute effective for all sales made on or after July 1, 2014. The New Jersey statute is virtually identical to the click-through nexus statute enacted by New York State lawmakers in 2008. That measure was held to be constitutional on its face by New York's highest court last year. Under the new law, a seller will be presumed to be soliciting business through a New Jersey independent contractor or other representative if the seller enters into an agreement with the representative or independent contractor that has physical presence in the state to, directly or indirectly, through a link on an Internet website or otherwise, refer potential customers to the seller in exchange for a commission or other consideration. The presumption applies only if the seller has cumulative gross receipts in excess of $10,000 from sales to New Jersey customers resulting from all such agreements during the preceding four quarterly periods. The presumption can be rebutted if the seller demonstrates that the in-state representative or independent contractor with whom it has entered into an agreement did not engage in any solicitation activities on behalf of the seller that would satisfy the nexus requirements of the U.S. Constitution during the time period in question.

Michigan: Taxpayer May Use Compact Election to Compute Business Tax

On July 14, the Michigan Supreme Court issued a taxpayer-favorable decision holding that the taxpayer was entitled to use the Multistate Tax Compact's elective three-factor apportionment formula based on gross receipts, payroll, and property to calculate its 2008 Michigan Business Tax. International Business Machines Corp. v. Department of Treasury, No. 146440 (Mich. July 14, 2014)

The Michigan Court of Appeals in a November 2012 unpublished decision held that a taxpayer could not elect to use the Multistate Tax Compact's allocation and apportionment provisions in computing its Michigan Business Tax liability because the state's adoption of the mandatory MBT apportionment provisions implicitly repealed the Compact election.

In its July 14 opinion, the Michigan Supreme Court reversed the Court of Appeals and held that the modified gross receipts tax is an income tax for purposes of the Multistate Tax Compact and that the taxpayer was entitled to use the compact's elective three-factor apportionment formula to calculate its 2008 Michigan taxes.

June 2014

Temporary and Proposed Regulations Allows Alternative Simplified Credit Elections on Amended Returns

On June 2, the Treasury Department and IRS released temporary regulations (T.D. 9666) and, by cross-reference, proposed regulations (REG-133495-13) to allow the alternative simplified credit (ASC) election for purposes of the research credit on an amended return if a return claiming the credit has not previously been filed for that tax year.

The ASC is an elective method of computing the research credit. A taxpayer that elects to use the ASC is allowed a credit equal to 14% of the amount by which its qualified research expenses (QREs) for the tax year exceed 50% of its average QREs for the three preceding tax years. An electing taxpayer that does not have any QREs in one or more of the three preceding tax year is allowed an ASC equal to 6% of its QREs for the tax year. An election to use the ASC remains in effect until it is revoked with the consent of the IRS.

The preamble to the temporary regulations explains that Treasury and the IRS received numerous requests to amend the June 2011 regulations so as to allow taxpayers to make an ASC election on an amended return. Proponents of this change explained that the burden of substantiating qualified expenditures for the base period under the regular credit can be costly and time-consuming, and suggested that additional time was often needed to determine whether to claim the regular credit or the ASC. In response to these requests, the temporary and proposed regulations remove the rule prohibiting taxpayers from making an ASC election on an amended return.

The temporary regulations also provide, however, that a taxpayer that previously claimed the credit on an original or amended return for a tax year may not then make an ASC election for that tax year on an amended return. Also, the temporary regulations provide that a taxpayer that is a member of a controlled group in a tax year may not make an ASC election for that tax year on an amended return if any member of the controlled group for that year previously claimed the research credit using a method other than the ASC on an original or amended return for that tax year.

The temporary regulations apply to elections with respect to tax years ending on or after June 3, 2014. The temporary regulations expire on June 2, 2017. However, a taxpayer may rely on these regulations to make an ASC election for a tax year ending prior to June 3, 2014, if the taxpayer makes the election before the period of limitations for assessment of tax has expired for that year. Comments and requests for a public hearing with respect to the proposed regulations are due by the date that is 90 days after June 3, 2014.

Final Regulations to Modify Circular 230

On June 9, the Treasury Department and IRS released final regulations (T.D. 9668) that amend Circular 230 which provides standards for written tax advice and other rules concerning tax practitioners. The final regulations adopt the changed proposed in the notice of proposed rulemaking (REG–138367–06) issued On September 17, 2012 with some revisions.

The modifications adopted by the final regulations include the following:

- Covered opinion rules are eliminated.
- Requirements for written advice are revised to provide expanded rules to replace the covered opinion rules intended to be adhered by all practitioners when rendering written advice.
- The requirement for firms to establish procedures to ensure compliance with Circular 230 is expanded to apply to all provisions in Subparts A, B, and C of Circular 230.
- General standard of competence is updated to provide that a practitioner must possess appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.
- A practitioner is prohibited from endorsing or otherwise negotiating any check issued to a client by the government in respect of a Federal tax liability, including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated.
- Expedited suspension procedure is established to allow immediate suspension of a practitioner who has engaged in certain conduct.

The amended Circular 230 will apply to written tax advice rendered on or after June 12, 2014.

Final Version of Instructions for Form W-8BEN-E Released

On June 25, the IRS posted the final version of the instructions for Form W-8BEN-E, *Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities).*

The IRS previously released the final version of Form W-8BEN-E. The form is intended to be completed by a non-U.S.

entity who is certifying it is the non-U.S. beneficial owner of a payment of income for current withholding tax purposes as well as to provide its FATCA status as either payee or account holder of a foreign financial institution (FFI).

The instructions for Form W-8BEN-E explain that Form W-8BEN-E—along with Forms W-8BEN, W-8IMY, W-8ECI, and W-8EXP—reflects the withholding and documentation requirements of FATCA as follows:

- Under FATCA, FFIs that are participating FFIs—and certain registered deemed-compliant FFIs—are generally required to identify their U.S. account holders, regardless of whether a payment subject to withholding is made to the account.
- U.S. withholding agents and FFIs will be required to begin withholding under FATCA on certain payments beginning on July 1, 2014.
- Form W-8BEN-E is to be used exclusively by entities to document their status both as a payee under FATCA and beneficial owner under the withholding tax rules (including a claim of treaty benefits for reduced withholding).
- Individuals documenting their foreign status (or making a claim of treaty benefits for reduced withholding) are to use Form W-8BEN instead of Form W-8BEN-E.
- An entity account holder holding accounts with certain FFIs that does not document its applicable FATCA status when required may be treated as a recalcitrant account holder or nonparticipating FFI and will be subject to 30% withholding on payments it receives from the FFI.

May 2014

Competent Authority Statistics for 2013 Released

On May 29, the IRS released a report providing statistics of Competent Authority actions for 2013. As the U.S. Competent Authority has jurisdiction over both the Advance Pricing and Mutual Agreement (APMA) Program and the Treaty Assistance and Interpretation Team (TAIT), the report contains statistics on mutual agreement procedure (MAP) request cases handled by both APMA and TAIT but excludes Advance Pricing Agreement (APA) information which is reported separately. Note that 2013 statistics are for 15 months starting from October 1, 2012 through December 31, 2013 while previous fiscal years covered 12 months from October 1 through September 30.

APMA

Requests Received

	Adjustments Initiated by U.S.	Foreign	COMBINED
2009	24	134	158
2010	23	77	100
2011	25	141	166
2012	51	130	181
2013	48	218	266

Cases Resolved

	Adjustments Initiated by U.S.	Foreign	COMBINED
2009	30	55	85
2010	31	115	146
2011	18	119	137
2012	16	74	90
2013	40	119	159

Case Resolutions 2013

	Adjustments Initiated by U.S.	Foreign	COMBINED
• Case Withdrawn by Taxpayer	5	9	14
• Total Adjustment Withdrawn by Initiating Tax Authority	18	18	36
• Full Correlative Relief	11	19	30
• Partial Correlative Relief and Partial Withdrawal (Full Relief)	5	59	64
• Partial Correlative Relief or Partial Withdrawal (Partial Relief)	1	7	8
• No Relief	0	7	7
• Total Number of Cases	40	119	159

Pending Requests

	Adjustments Initiated by U.S.	Foreign	COMBINED
2013	91	433	524

TAIT

Requests Received

	Cases/Matters Initiated by U.S.	Foreign	COMBINED
2009	45	41	86
2010	31	48	79
2011	23	48	71
2012	18	37	55
2013	77	60	137

Cases Resolved

	Cases/Matters Initiated by U.S.	Foreign	COMBINED
2009	22	20	42
2010	23	41	64
2011	46	58	104
2012	16	34	50
2013	53	49	102

Pending Requests

	Cases/Matters Initiated by U.S.	Foreign	COMBINED
2013	91	118	209

Anti-Corporate Inversion Bills Submitted in both House and Senate

On May 20, Senator Carl Levin announced that legislation that would "tighten" rules on corporate tax avoidance through "inversion" i.e. the practice of a corporate taxpayer re-incorporating offshore to avoid paying U.S. taxes—has been introduced as the Stop Corporate Inversions Act of 2014. The bill would:

- Effectively impose a two-year sunset rule for inversions, including the practice of shifting a corporation's tax residence overseas through acquisition of an offshore company to avoid paying U.S. income taxes
- Significantly reduce a tax "loophole" that allows U.S. companies that merge with foreign companies to reincorporate offshore in lower-tax jurisdictions to avoid being subject to U.S. tax on their overseas earnings.

Under current U.S. tax law, the merged company is treated as a foreign company if more than 20% of the stock of the merged company is owned by stockholders who were not stockholders of the U.S. company or if the merged company has at least 25% of its employees, sales, and assets where it is incorporated.

The legislation would increase the needed percentage change in stock ownership from 20% to 50% and would provide that the merged company would nevertheless continue to be treated as a domestic U.S. company for tax purposes if management and control of the merged company remains in the United States and either 25% of its employees or sales or assets are located in the United States.

The bill would add a two-year sunset rule with respect to inversions that do not meet the proposed stricter tests, so that Congress can consider a long-term solution as part of general corporate tax reform.

On May 23, House Ways and Means Committee ranking member Sandy Levin introduced a bill that contains provisions that are substantially similar to those proposed in the Senate bill.

Proposed Regulations - Revised Definition of "Acquiring Corporation" under Section 381

On May 6, the Treasury Department and IRS released proposed regulations (REG-131239-13) that modify the definition of an "acquiring corporation" under section 381.

Section 381 provides that the acquiring corporation ("Acquiring Corporation") in a tax-free reorganization will inherit the

tax attributes of the target ("Target"). Current regulations under section 381 provide that the Acquiring Corporation for this purpose either will be the corporation that directly acquires the Target assets or another corporation if that other corporation receives all of the assets of the Target pursuant to the plan of reorganization.

Under this rule, for example, if Target merges into corporation X in a transaction constituting a tax-free reorganization and X transfers less than all of the Target assets to a wholly owned subsidiary ("Sub") as a part of the plan of reorganization, X will be the Acquiring Corporation and inherit all of Target's attributes. On the other hand, if X transfers all of Target's assets to Sub as part of the plan of reorganization, Sub will be the Acquiring Corporation and inherit all of Target's tax attributes.

The proposed regulations would provide that the first corporation to receive Target's assets in the reorganization would retain all of Target's attributes described in section 381(c) regardless of whether it transferred some, all, or none of Target assets pursuant to the reorganization.

Questions?

If you have any questions about this article please reach out to your KPMG engagement team or the contact listed with this article.

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