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Summaries for the 30th Annual TEI-SJSU High Technology Tax Institute

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Introduction

The High Technology Tax Institute provides a high quality tax education conference that brings together nationally and internationally recognized practitioners and government representatives to provide insights on current high technology tax matters of interest to corporate tax departments, accounting and law firms, the IRS, academics and graduate tax students.

Certain sessions from the 2014 event are summarized in the articles to follow. We encourage you to read these summaries and to visit the High Tech Tax Institute website to view current and past conference materials in greater detail. If you were not able to attend the 2014 Institute, we hope this overview of the topics covered will encourage you to attend a future conference.

FATCA (Foreign Account Tax Compliance Act) and Its Relevance to High Tech Companies

By: Amy Yue, CPA, *Open University Student*

The technology evolution has facilitated the mobility and globalization of business, but it increases the complexity of tax compliance for many taxpayers. The Foreign Account Tax Compliance Act (FATCA) is intended to identify and deter the evasion of US tax by US persons who hold assets outside the US. The latest development and the effects of FATCA on high tech companies were discussed at the 30th TEI-SJSU High Tech Tax Institute, which was held on November 10, 2014, in Palo Alto, California in a panel comprised of Pamela Endreny, Partner with Skadden; Peter Larsen, Senior Manager with Deloitte Tax LLP; and Dharmish Pandya, Partner with DLA Piper.

The panel started on who FATCA affects and the impact on those taxpayers. FATCA creates new information reporting and withholding requirements for payments made to certain foreign financial institutions and other foreign entities. Generally, withholding agents must withhold 30% of withholdable payments to non-participating Foreign Financial Institutions (FFI) and non-certifying passive Non-Financial Foreign Entities (NFFE). A withholdable payment is a payment of either: U.S. source income that is fixed, determinable, annual or periodical; or gross proceeds from the sale or other disposition (including redemption) of property that can produce US-sourced interest or dividend income.

To avoid withholding on US-sourced income, the FFIs are required to report account information of US taxpayers to the IRS, and the NFFEs must either report “substantial US owners” or certify that there is no substantial US owners. As the US adopts a worldwide tax system, US persons need to report and pay tax on income from both US and foreign sources. FATCA forms greater transparency for the IRS can match information from FFI and NFFE to US persons’ tax returns.

To simplify FATCA compliance, foreign countries may sign intergovernmental agreements (IGA) with the US government. The IGAs allow FFIs to either directly report to domestic tax authorities and the IRS separately, or report to the domestic tax authority, which will then exchange information with the IRS. FFIs in IGA jurisdictions are deemed FATCA compliant. Over 100 countries have entered or are negotiating IGAs. Countries that have signed IGAs include: France, Germany, Ireland, Italy, Netherland, United Kingdom, Canada, Mexico, China, Hong Kong, India, Japan, Singapore, South Korea, Taiwan and Thailand.

When talking about unique issues for high tech companies, the panel provided key classifications of FATCA affected entities such as withholding agent, FFI and NFFE. Depending on the classification, foreign entities are to complete form W-8s or “self-certifications” upon request from financial counterparties. US withholding agents are required to take the following actions to comply with FATCA: (1) identify accounts subject to FATCA, (2) obtain required documentation from account holders and verify the FATCA

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status claimed, (3) determine if 30% withholding under FATCA applies and remit amounts accordingly, and (4) provide information reporting to the IRS. The withholding requirement went into effect on July 1, 2014 and the reporting requirement started on March 31, 2015.

While understanding documentation, reporting and withholding requirements of FATCA, affected entities should develop plans to get ready to comply with FATCA as its implementation stage rolls out.

Finalized Standards for Revenue Recognition

By: Chenglei Liu, *MST Student*

Four Silicon Valley experts spoke about the latest standards for revenue recognition and the related tax considerations: Amy Chan, Director, KPMG; Irine Dibowitz, Executive Director, Ernst & Young; Patrice Mano, Partner, Deloitte; and Jesus Ochoa, Tax Director, PwC.

On May 28, 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued converged standards on revenue recognition, which include ASC 606 and IFRS 15. These final standards are a product of a multi-year joint project between the FASB and IASB. The new standards virtually supersede all US GAAP and IFRS guidance on revenue recognition and require more estimates and judgments than current guidance. Following the rules, the effective date for public companies is the first quarter of 2017, but for nonpublic companies it is 2018. Public companies cannot make early adoption, but nonpublic companies may adopt as early as the effective date for public companies.

These standards are consistent between the FASB and IASB except for the following five areas:

1. The FASB version establishes a higher collectability threshold when assessing whether a contract exists (based on existing definitions of "probable" under US GAAP and IFRS).

2. FASB requires more interim disclosures than IASB.

3. IASB allows early adoption.

4. IASB allows an entity to reverse impairment losses on assets recognized.

5. FASB provides a relief for nonpublic entities relating to specific disclosure requirements, effective date, and transaction.

The core principle for those standards is to recognize revenue in a way that can correctly reflect the transaction of promised goods or services. The recognized revenue should be the amount that the transferred entity expects to be entitled in exchange of those goods or services. In order to achieve the core principle, companies may apply the following five steps:

Step 1: Identify the contract(s) with the customer

Step 2: Identify the performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate transaction price to the performance obligations

Step 5: Recognize revenue when each performance obligation is satisfied

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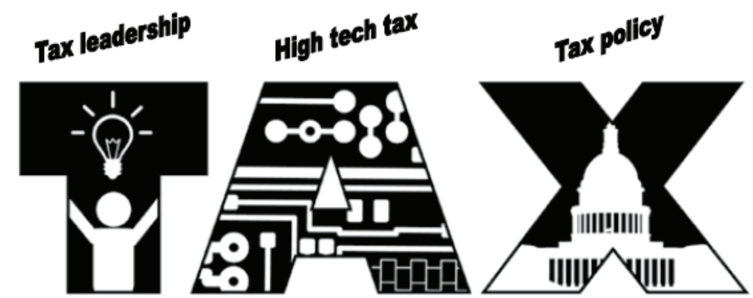
Companies should also consider these changes in revenue recognition from a tax perspective. Certain tax liabilities are based on statutory financial statements. For example, companies who apply the deferral method for advance payment should determine their deferred taxes by reference to the amounts deferred for financial statement purpose. Also, these revenue recognition standards affect intercompany transactions. Companies should evaluate the intercompany prices and transfer pricing policies since those new standards will change revenue, profits, and third party comparables that are used to determine transfer pricing. In addition, taxpayers may need to review the methodology for the apportionment data of compiling sales.

For income tax considerations, these new standards will give rise to new temporary differences or require a different computation of existing temporary differences. Therefore, companies may need to revise their process and data collection tools. Accordingly, the valuation allowance may change due to the change of deferred tax assets, temporary difference reversals or expected future taxable income.

Multinational companies need to consider the effects of changes in revenue recognition on foreign subsidiaries. They should assess the changes jurisdiction by jurisdiction for both financial reporting and tax purposes. Companies should also consider the cumulative current and deferred tax consequences for the period of adopting the new standard.

Furthermore, there are some indirect tax effects from those new standards. Companies should review the regulations of states which has indirect state tax on gross receipts or revenue and consider the change of state net worth tax if the retained earing changes upon adoption of the new standards.



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Our goal – to provide the highest quality tax education to meet the needs of the Silicon Valley community.

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A Panel Discussion of M&A Developments and Acquisition Planning

By: Ryan Zhou, *MST Student*

Four M&A experts spoke about the latest developments in domestic M&A and cross-broader transactions: Gabe Gartner, Principal, PwC; Ivan Humphreys, Partner, Wilson Sonsini; David Hering, National Tax M&A Partner, KPMG; and Mark Jewett, M&A Tax Director, Amazon.com.

Mark Jewett started the discussion with an overview of the M&A process from an "in-house" practitioner's perspective. He summarized that his responsibility in an M&A transaction is to manage the process, which requires understanding the nature of the deal.

A typical M&A process includes following five stages and Mr. Jewett highlighted the importance of each stage.

- **Pre-Term Sheet** – The importance of a pre-term sheet is to figure out the letter of intent by identifying deal structure options, analyzing tax attributes and identifying tax representations and indemnities.
- **Due Diligence** – Mr. Jewett highlighted four important points of the Due Diligence stage:
    a. Understanding the operational process and disclosures.
    b. Analyzing tax attributes that can drive more value into the deal.
    c. Integration. To consider a company and an acquired structure that are necessary to integrate into the overall business process – including moving people and assets accordingly.
    d. Purchase Accounting. Mr. Jewett emphasized that he always needs accountants to identify tax attributes and historical tax differences, significant deficiencies and material weaknesses at the due diligence stage.
- **DPA (Definitive Purchase Agreement) Negotiations -** A DPA is a legal document that records the terms and conditions for a purchase or sale of a business. It is a mutually binding contract between the buyer and seller. Mr. Jewett pointed out that it is key for tax practitioners to understand the architectural structure of these agreements from a tax perspective to make sure the direction of a merger is correct. He continued to emphasize the importance of including the tax indemnity section in agreements because M&A trends in recent years are leading towards acquiring profitable companies.
- **Closing** – Panelists explicitly pointed out one important part of the closing process often is forgotten, is to withhold the proper amount of payroll.

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- **Post-Close Integration** - Mr. Jewett shared that they often spend an enormous amount of time on moving IP rights among various tax regimes at this stage of the M&A process. They also need to create an effective tax structure to avoid having inter-company transactions.

The panel discussion moved on to discussing the external IP buy-in structure.

Mr. Jewett shared with the audience that "I always structure a deal as an asset purchase if I can." He further explained his idea in two steps:

Step 1: The Foreign IP company directly acquires assets or licenses for ROW ("right of way") IP rights from a target company.

Step 2: The US IP company acquires all US legal titles and IP rights that are subject to the foreign IP company licenses.

In addition to the benefits of amortizing the step-up basis, Mr. Jewett explained that the asset purchase structure can push the buy-in cost into the transaction, and there will be no post transaction tax consequences.

Ivan Humphreys presented on how to extract value in domestic acquisitions. He illustrated the concept with four typical scenarios that include venture-backed loss corporations with or without stock option pool, venture-backed loss corporations acquired at a breakeven point, and where the target is a pass through entity.

The next panelist Gabe Grartner from PwC updated the audience on M&A technical developments. He briefly illustrated IRS Notice 2014-32, which stated that Triangular Reorganization subject to Treas. Reg. § 1.367(b)-10 would continue to result in a deemed distribution, but a deemed contribution is eliminated.

The last topic of the discussion led by David Hering from KPMG was on Inversion Transactions.

Mr. Hering introduced the basic understanding of three different charges that U.S. taxing authorities have developed to prevent corporate inversions. He emphasized the concept that "inversion really does nothing with your effective tax rate" and highlighted the IRS Notice 2014-52's measure on how the government would make inversions more costly.

All the panelists with ample experience brought in the most current updates and insights of M&A Developments and Acquisition Planning. The audience was well informed on these topics.