

Foreign Tax Processing

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It's a really big topic

There are many things we could talk about

My expertise is in taxability of corporate actions

Let's start with a hypothetical corporate action

Setting Up A Hypothetical

- Company A (incorporated in Spain) trades in US as sponsored ADR
- Company A distributes rights in home country
- Rights may be
 1. Exercised for stock of Company B at no extra cost
 2. Sold for cash on local stock market
 3. Waived and shareholder receives pre-determined cash payment
- Depository will elect option 2, unless otherwise instructed
- No US tax opinion provided
- Spanish tax
 - Options 1 and 2, US holders not subject to Spanish tax
 - Option 3, US holders subject to Spanish withholding tax

Identifying Possible US Tax Consequences

- Should this be treated as a rights offering?
- Should this be treated as a spin-off?
- Should this be treated as a dividend?
- Effect on basis and holding period is different depending on outcome
- What other tax issues may arise?
 - PFIC status
 - Capital gain/loss (sale of rights)
 - Currency gain/loss
 - Foreign tax credit



Is This A Rights Offering?

■ Sec 305

- Generally, any distribution of stock, stock rights, by a corporation to its nontaxable
- “Stock rights” means rights to acquire stock in the corporation distributing rights

■ Typical rights offering

- Nontaxable
- Possibly allocate basis between stock and right
- Allocation is mandatory if FMV of rights is 15% or more versus stock
- Basis of stock acquired equals basis of rights plus purchase price
- Holding period of stock acquired begins on date of exercise



Is This A Spin-off?

■ Sec 355

- Distribution must be of stock at least 80% controlled by company A
- Both company A and company B must be engaged in the active conduct of a trade or business
- Trade or business must have been actively conducted for 5 years
- Trade or business must not have been acquired during past 5 years in a taxable transaction
- All of company B stock, or enough to constitute control, must be distributed
- Additional rules and court interpretations apply

■ Typical spin-off offering

- Nontaxable
- Allocate basis between stock A and stock B
- Holding period of stock received carries forward



Is This A Dividend?

■ Sec 301

- If distribution does not qualify as spin-off or rights offering, probably taxable as a dividend

■ Not a spin-off

- If distribution violates any of the rules under Sec. 355
- If rights distribution and option to purchase stock B are not integrated

■ Not a rights offering if

- Rights are exercisable for purchase of stock in another company
- If some shareholders can receive cash instead of stock

■ If this is a dividend

- FMV of rights or cash received is taxed as ordinary income to the extent of company's E&P
- Potential for return of capital treatment



Cost Basis Reporting Issues

- If distribution is a rights offering
 - Possible basis allocation may reduce basis of stock A
 - Basis of stock B equals basis of rights (maybe zero)
 - Holding period of stock B begins on date of exercise
- If distribution is a spin-off
 - Allocate basis between stock A and stock B
 - Holding period of stock B carries forward
 - Option 2 (sell stock B in local market) still results in reduced basis of stock A
- If distribution is a dividend
 - Basis of stock A remains unchanged
 - Basis of stock A may be reduced if dividend is reclassified as return or capital
 - Basis of stock B equals FMV on date of distribution
- Bottom line: You need to know US tax consequences of this event



Additional Tax Issues



- PFIC rules trump other tax treatment
 - Gain or excess distribution taxed as ordinary income
 - Allocated over entire holding period (could be many years)
 - Taxed at the highest rate for any given year
 - Subject to interest for previous calendar years
- If receipt of rights is treated as a dividend may be foreign source income which could be eligible for foreign tax credit
- If right is sold in local market
 - Could be separate taxable event treated as capital gain/loss
 - Proceeds in local currency converted into US dollars could result in ordinary gain/loss

No US Tax Opinion - Now What?

- Cost Basis Reporting Law (CBRL) requires brokers to report basis of covered security
- Brokers need to determine tax consequences of corporate action in order to establish cost basis
- “I don’ t know” is not an option
- Wolters Kluwer offers two solutions:
 - FCATS
 - Capital Changes Tax Commentary



FCATS

(Foreign Corporate Action Taxability Service)



What Is FCATS

- A corporate action taxability service offered by Wolters Kluwer
- Covers entire universe of US and foreign corporate actions
(Based on SIX Telekurs and Capital Changes data)
- Automates key operational and tax data
- Determines US tax consequences based on following criteria:
 1. IRS Form 8937
 2. Company tax opinion
 3. Capital Changes Tax Commentary
 4. Independent review by Capital Changes team
 5. Proprietary tax rules developed by tax experts at Wolters Kluwer
- Result: Taxability, basis and FMV available for all securities of interest

Note: FCATS has computed adjustments for over 1.3 million foreign securities since Jan. 1, 2011

FCATS Screenshot

Search SOI Audit Log

Search Security and Corporate Actions Search Corporate Actions only Search Securities only Clear Search Parameters

Country of Trade: -- ALL -- * CUSIP : Partner: BNYMAS Filtered by: Target Security Only SEARCH

* Ex/Expiration Date From: 04/01/2012 To: 04/19/2012 CA Type: -- ALL -- CA SubType: -- ALL --

Required fields includes either "CUSIP", "SEDOL", "ISIN", or "Ex/Expiration Date" range

SEARCH RESULTS FOR BNYMAS

List of Corporate Actions: DDF EXPORT

SHOW ALL DESCRIPTIONS HIDE ALL DESCRIPTIONS

#	CA Type	Country	IDENTIFIER	Symbol	CA Status	Ex/Expiration	Ap.Order
1	Warrants Expire	AU	s: B3W8JT5		Executable	04/01/2012	1
2	Stock Dividend	OM	s: 6660420	OIBB	Executable	04/01/2012	1
3	Merger	JP	s: B0152K6	3332	Executable	04/01/2012	1
4	Merger	JP	s: B249G75	9234	Executable	04/01/2012	1
5	Merger	JP	s: 6703295	8574	Executable	04/01/2012	1
6	Merger	JP	s: 6899859	6352	Executable	04/01/2012	1
7	Merger	JP	s: 6896634	5954	Executable	04/01/2012	1
8	Stock Dividend	OM	s: B141016	OMV5	Executable	04/01/2012	1
9	Stock Dividend	LK	s: 6161321	COMBN	Executable	04/02/2012	1
10	Stock Dividend	LK	s: 6406970	HNBN	Executable	04/02/2012	1
11	Stock Dividend	LK	s: 6771322		Executable	04/02/2012	1
12	Assimilation	HK	s: B6X1VG4	2988	Executable	04/02/2012	1
13	Return of Capital	CH	s: 7385722	NOBN	Executable	04/02/2012	1
14	Stock Dividend	BR	s: B27WYK0	SULA11	Executable	04/02/2012	1
15	Reverse/Forward Split	IT	s: 5107832	UNI	Executable	04/02/2012	1
16	Exchange	JP	s: B1T2TF0	3846	Executable	04/02/2012	1
17	Reverse/Forward Split	IT	s: 5107876	UNIP	Executable	04/02/2012	1
18	Merger	JP	s: B1GN552	3829	Executable	04/02/2012	1
19	Warrants Expire	FR	s: B78H3K2		Executable	04/03/2012	1
20	Return of Capital	CH	s: 5914270	ALLN	Executable	04/03/2012	1
21	Return of Capital	CH	s: 4512857	EDHN	Executable	04/03/2012	1
22	Stock Split	BR	s: B1H6R62	ODPV3	Executable	04/03/2012	1
23	Cash Merger	DE	i: DE000A1MMBF3		Executable	04/03/2012	1

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CORPORATE ACTION FOR BNYMAS

Corporate Action details:

Corporate Action: **Distribution/Spin-Off** Mandatory/Voluntary: **Mandatory**
 Ex/Expiration Date: 04/12/2012 Pay Date: 04/20/2012
 Application Order: 1 FX Rate: 1.028590000

Target Security details:

Country: AU Currency: AUD
 CUSIP: SEDOL: 6648244
 ISIN: AU000000NRT0 Symbol: NRT
 Security: NOVOGEN LTD
 Start Date: 07/26/1994 End Date:
 Security Type: Stock

Option Details:

Taxability: **Taxable**

New Security Details:

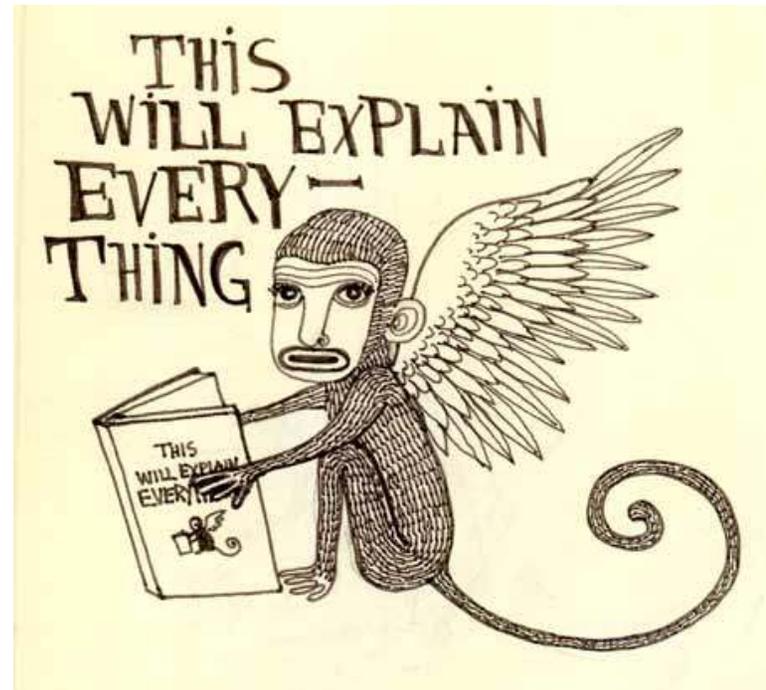
New Country:	AU	New Currency:	---	New CUSIP:
New SEDOL:	B7M5N1	New ISIN:	AU0000NRTXE2	New Symbol:
New Security:	NOVOGEN/MARSHAL I12			
New FMV:	0.082500000	New Stock Rate:	0.075000000	
Allocation %:	100	New Fraction Method:	Round Down	

Capital Changes Tax Commentary



Capital Changes Tax Commentary

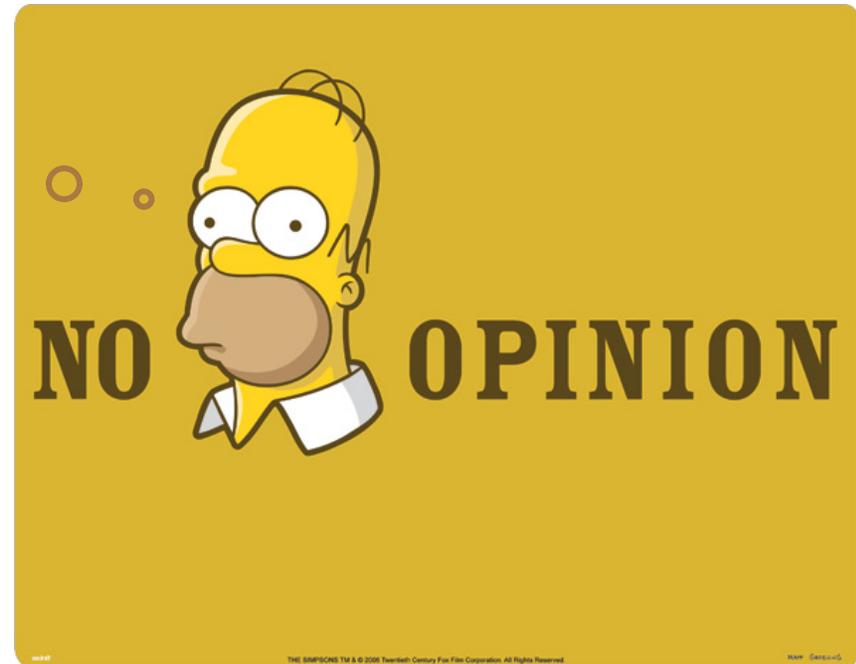
- Provides guidance when company does not provide US tax opinion
- Capital Changes analysts review relevant facts and circumstances
- Identifies key US tax issues
- Determines most relevant Internal Revenue Code sections
- Provides basis and FMV depending on one or more outcomes



Real-World Example: Neptune Technologies

- October 31, Neptune Technologies & Bioresources Inc. [NASDAQ: NEPT] [TSX: NTB] will distribute 2 million units of NeuroBioPharm Inc. to holders of Neptune common
- Neptune shareholders will receive 1 NeuroBio unit for each lot of approximately 29.27 Neptune shares (approximately 0.034165 NeuroBio unit per Neptune share)
- Each unit will consist of
 - 1 class A subordinated voting share, and
 - 2 series 2011-1 warrants
- Each warrant entitles holder to purchase one class A share at \$0.40 plus transfer premium of \$0.35 payable to Neptune upon exercise. Warrants expire in 2014 or after class A shares are listed on a recognized exchange
- NeuroBio securities not currently listed on any public exchange

Taxability



- Canadian tax consequences:

Receipt of class A subordinate voting shares and warrants considered taxable dividend

Non-Canadian resident holders subject to 25% withholding on amount of dividend, subject to reduction under tax treaty

Commentary On Neptune Distribution

- Distribution by company A of company B stock, typically treated as
 - Taxable dividend (Code Sec. 301), or
 - Tax-free spin-off (Code Sec. 355)
- Rules to qualify under Code Sec. 355 are complex, e.g.
 - Distribution must be with respect to company A stock
 - Distribution must be of stock controlled by company A (at least 80%)
 - Both company A and company B must be engaged in the active conduct of a trade or business
 - Trade or business must have been actively conducted for 5 years
 - Trade or business must not have been acquired during past 5 years in a taxable transaction
 - All of company B stock, or enough to constitute control, must be distributed
 - Additional rules and court interpretations apply
- Failure to meet Code Sec. 355 rules means Code Sec. 301 applies

Some Relevant Facts - Company History

- Neptune is a biotechnology company engaged primarily in the development, manufacture and commercialization of marine-derived omega-3 polyunsaturated fatty acids
- [NeuroBio was incorporated in 2008](#) as a 99%-owned subsidiary of Neptune. NeuroBio develops, for further commercialization, omega-3 phospholipids medical foods, over-the-counter products and prescription drugs
- In October 2008, Neptune issued an exclusive worldwide license to its subsidiary, NeuroBio, to [research, develop and commercialize new](#) active pharmaceutical ingredients (“API”) based on Neptune’s proprietary omega-3 phospholipid technology and intellectual property
- NeuroBio’s goal is to become a leading biopharmaceutical company dedicated to the research, development and commercialization of API for the management of neurodevelopmental, memory, concentration, learning and neurological disorders, from prevention to treatment

More Facts - NeuroBio Capital Structure

- Neptune currently holds 99% of voting rights of NeuroBio as follows:
 - 8,500, 990 class A Subordinate Voting Shares (representing 99.99% of shares outstanding)
 - 2,475,000 class B multiple voting shares (representing 99% of shares outstanding)
 - 17,325,000 Class G non-voting shares (representing 99% of shares outstanding)
 - 25,740,000 Class H subordinate voting shares (representing 99% of shares outstanding)

- Neptune also holds
 - 5,940,000 Series 2011-1 warrants,
 - 1,885,574 Series 2011-2 warrants
 - 46,246 Series 2011-3 warrants

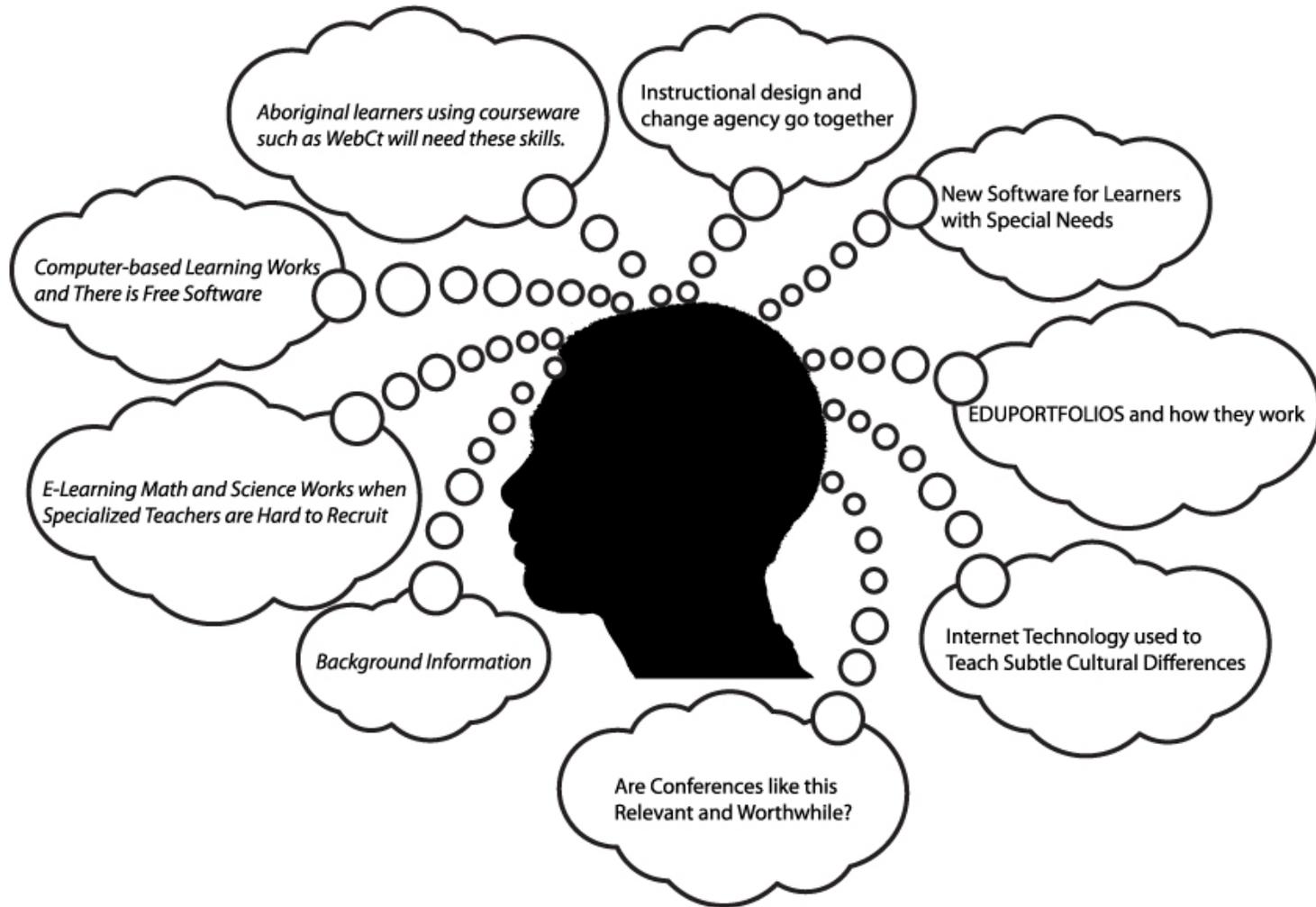
- Upon completion of event, Neptune will hold
 - **Approximately 76%** of shares
 - Approximately 32.33% of series 2011-1 warrants
 - **Approximately 96%** of voting rights of NeuroBio

So What's The Answer?

- Distribution probably does not qualify as tax-free spin-off (Code Sec. 355)
 - NeuroBio was formed in 2008
 - Unclear whether it is actively engaged in a trade or business
 - After distribution, Neptune retains approximately 76% of class A shares and 96% of voting rights

- Receipt of NeuroBio units is probably taxable under Code Sec 301
 - Taxable as a dividend equal to FMV of units on date of distribution
 - Basis of NeuroBio unit equals FMV on date of distribution
 - **Note:** Allocate basis among common and warrants based on their relative FMV
 - Holding period begins on day after distribution

Some Thoughts About Sec. 302



Sec. 302 (Distributions To Non-US Residents)

- Distributions in redemption of stock may result in either:
 - Capital gains treatment
 - Dividend treatment
- Capital gains treatment applies if distribution is:
 1. Not essentially equivalent to a dividend, or
 2. Substantially disproportionate with respect to the shareholder, or
 3. In complete termination of shareholder's interest in corporation, or
 4. In redemption of stock held by individual shareholder, and in partial liquidation of the distributing corporation
- Otherwise dividend treatment applies
- Important for US-source redemption payments
- Redemption payments to nonresident aliens (NRAs) are subject to US withholding tax unless payment qualifies for capital gains treatment

Sec. 1441 (Liability For Withholding)

- Who must withhold?
 - Any person that has control, receipt, custody, disposal or payment of any item of income of a foreign person (NRA) that is subject to withholding
- What is subject to withholding?
 - Gross amount of U.S. source fixed or determinable annual or periodical income (FDAP)
 - Includes dividends and interest
- When in doubt, withhold
 - Generally, if amount or source of income is undetermined at time of payment, **agent must withhold** on entire amount
 - Liability for under-withholding rests with US agent
- Sec. 302: **Withholding agent is liable** for failure to withhold on Sec. 302 payment, if dividend in hands of NRA

Proposed Escrow Regulations

■ Background

- PLR 200552007 (UBS)
- Proposed Reg. 1.1441-3(c)(5) for Sec. 302 payments (redemptions of stock)

■ Procedure

- Determine if Sec. 302 applies
- Place 30% of payment into escrow
- Send instructions/tender certification to NRA
- Include total shares outstanding immediately before and immediately after tender
- Explain Sec. 302 provisions and constructive ownership rules
- Within 60 Days NRA must certify dividend or capital gain treatment
- If no certification within 60 days: dividend
- If agent has reason to doubt capital gains treatment: dividend
- If dividend, apply escrow amount toward withholding liability and remit balance to NRA

Identifying Sec. 302 Payments

- Escrow procedure mitigates agent liability for improper tax treatment of Sec. 302 payments to NRAs
- Escrow procedure only works if agent identifies Sec. 302 payments
- Capital Changes can help
 - Identify which events subject to (or potentially subject to) Sec. 302
 - Identify total number of shares outstanding before and after tender



Questions

