



# SUPPLY CHAIN AND WORKING CAPITAL FINANCE SEMINAR

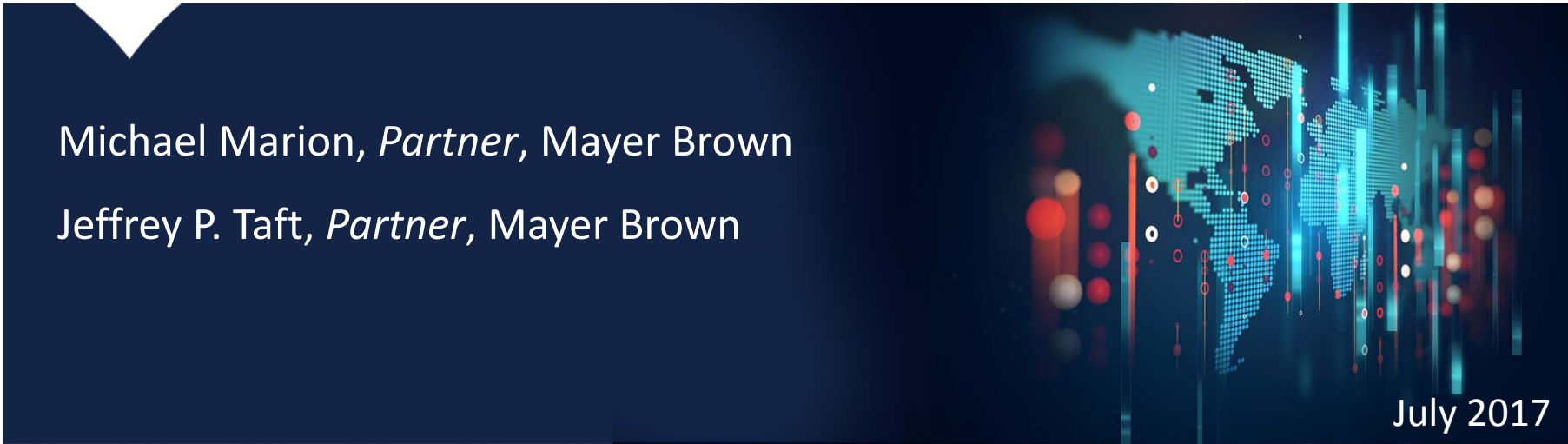
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# International Regulatory and Tax Issues When Purchasing Accounts Receivables

Michael Marion, *Partner*, Mayer Brown

Jeffrey P. Taft, *Partner*, Mayer Brown



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## International Tax Issues - General



- Two main U.S. federal tax issues non-US taxpayers (“offshore investors”) are concerned about when acquiring accounts receivable:
  - U.S. federal net income tax exposure
  - U.S. federal withholding tax imposed on collection of the receivables
- SALT exposure can be an additional drag on economics and can produce onerous tax filing obligations. States have become more aggressive with asserting tax nexus (e.g., “economic nexus” legislation). This trend bears observation by both non-US taxpayers and US taxpayers.

# International Tax Issues - Initial Characterization



- Tax characterization of a receivables purchase agreement: sale vs. financing.
  - Dramatically different results may be triggered by the initial characterization of the RPA.
  - If a sale, offshore investor should be treated as buying a pool of individual assets, and the withholding tax analysis should take place on a receivable-by-receivable basis.
  - If a financing, the offshore investor is likely to be treated as making one or more loans to the seller of the receivables (which could give rise to a US net federal income tax concern), and the withholding tax analysis should take place at the facility level (i.e., withholding risk on US source interest if seller is US).
  - Highly factual determination (the devil is in the details)

# International Tax Issues - Initial Characterization



- Factors suggesting sale:
  - “relinquishment of the substantial incidence of ownership” by the transferor- i.e., risk of loss.
  - No recourse to the seller of the receivables in relation to failure to pay receivable by underlying debtor.
  - Purchaser required to pay full purchase price to seller regardless of whether receivables are collected on.
- Factors suggesting loan secured by receivables (a financing):
  - RPA provides full recourse to the seller or includes certain deferred purchase price mechanics.
  - Losses on receivables are not borne by purchaser, including in flow purchase situations, where purchaser gets full credit for deemed receipts on prior receivables when making subsequent purchases.

## International Tax Issues - U.S. net income taxation



- Assuming the RPA is characterized as a sale, the offshore purchaser could be characterized as engaged in a U.S. trade or business (and thus subject to U.S. federal net income tax, except to the extent a treaty applies) as a result of either (a) its own actions in the US or (b) actions taken by an agent in the US.
- To minimize risk of (a) above, the purchaser should avoid having any employees inside the US and should not otherwise hold itself out to the U.S. public as a purchaser of receivables at a discount.
- To minimize risk of (b) above, each receivables purchase should be uncommitted, an independent credit decision thereon should be made outside of the US and the seller of the receivable should have the financial wherewithal to hold the receivable on its own balance sheet.
- The desired characterization of the offshore party is that it is not engaged in a trade or business at all, but is instead merely assuming credit risk as a passive investor.

# International Tax Issues - U.S. federal withholding tax



- Assuming the RPA is characterized as a sale, the US federal withholding tax analysis of payments in respect of the receivables would be expected to take place on a receivable-by-receivable basis.
- Interest Bearing Receivables
  - Assuming the obligors on the receivables are US, the interest paid on the receivables would be subject to 30% withholding tax (if no treaty applies), unless the receivable has a due date from the original invoice date of no more than 183 days (a “short term obligation”). One structuring option to avoid such tax may entail the use of the “portfolio interest exemption.”
- Non-Interest Bearing Receivables
  - *Services*. The interest imputation rules of 483 and 1274 only apply to deferred payments issued in relation to the sale of property, so non-interest bearing receivables resulting from the provision of services are not expected to result in any imputed interest income for U.S. tax purposes.
  - *Sale of Property*. 483 and 1274 can cause interest imputation that could be subject to US federal withholding tax, unless such receivable is a short term obligation. Again, for long term obligations, consider use of portfolio interest exemption.

## International Tax Issues - U.S. federal withholding tax (cont'd)



- Gain/Income in respect of “factoring discount” component
  - Basis recovery shouldn’t be taxable
  - Gain/income beyond basis recovery (the “factoring income”)
    - Treatment not entirely clear under the law, but it is expected that the factoring income would likely be characterized either as (a) gain from the sale of property or (b) OID income.
    - Gain shouldn’t be subject to US federal withholding tax because not FDAP income.
    - OID could be subject to US federal withholding tax, unless the receivable is a short term obligation. Consider also use of the portfolio interest exemption.



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# Business and Legal Roundtable


Massimo Capretta, *Partner*, Mayer Brown

David Ciancuillo, *Partner*, Mayer Brown

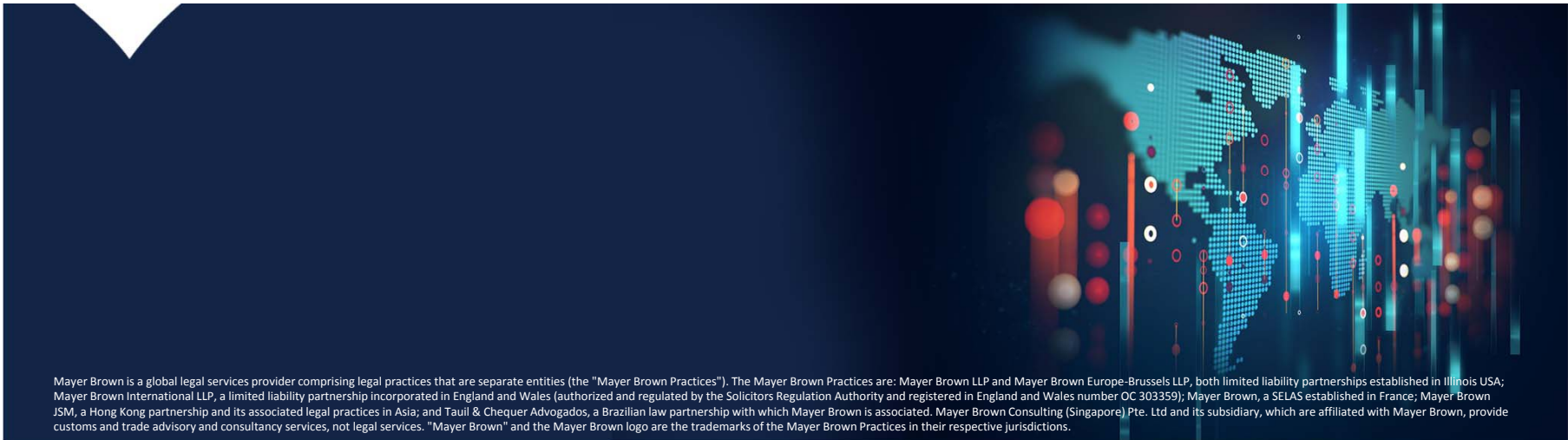
Miguel Pachicano, *Senior Vice President*, HSBC Global Trade & Receivables Finance

Deborah Scholl, *Director*, BNP Paribas Global Trade Solutions

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