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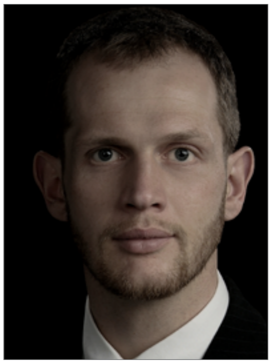

Dr. Tobias Binser
German Patent and Trademark Attorney

Patent Attorneys
Vonnemann Kloiber & Kollegen
EUROPEAN PATENT ATTORNEYS
Edisonstraße 2
87437 Kempten (Germany)
T +49 (0)83 12 32 91
F +49 (0)83 11 77 15
kempten@vonnemann.de
www.vonnemann.de

Design protection of spare parts in Germany: What IP right to choose?

In principle, the legal basis for industrial design protection within the European Union is harmonized in all member states of the European Union by virtue of the Directive 98/71/EC of the European Parliament and of the Council of 13 October 1998 on the legal protection of designs. However, the implementations of this Directive into German and Community law contain small but mighty differences. One of these differences concerns the design protection of spare parts.

The spare parts business is a very lucrative branch of the automobile manufacturing industry. As a consequence, this branch is highly competitive and the automobile manufacturers strive to obtain design protection for every single of the visible parts of their automobiles as comprehensive as possible. To achieve design protection in Germany three opportunities exist. Besides a less frequently used international registration with designation of Germany, an applicant can either apply for registration of a German design or for registration of a Community design, whereby the latter also grants protection in Germany, as Germany is a member state of the European Union. Protection of industrial designs is regulated in Germany by means of the German Design Act in the version of the publication of 24 February 2014, GDA in short, and Community-wide by means of the Council Regulation (EC) 6/2002 of 12 December 2001 on Community designs, RCD in short. At a first glance, a Community design seems quite attractive, as the requirements for design protection are substantially identical in the GDA and the RCD and it provides design protection in all 28 member states of the European Union for relatively little money.

Regarding spare parts however, the RCD comprises a severe restriction of design protection. Article 110 lit. 1 RCD states that protection as a Community design shall not exist for a design, which constitutes a component part of a complex product for the purpose of the repair of that complex product so as to restore its original appearance. Therefore, article 110 lit. 1 RCD is known in the literature as “spare parts clause”, “repair clause” or “must match exception”. The constellation described in article 110 lit. 1 RCD is exactly the constellation automobile manufacturers are often faced with. For instance in a recent case the Higher Regional Court Stuttgart (OLG Stuttgart, decision of 11 September 2014 – 2 U 46/14) had to deal with a lawsuit of an automobile manufacturer holding a Community design protecting a specific type of alloy rims for automobiles. The defendant was a company producing and marketing automobile alloy rims, which were visually basically identical to the protected Community design. In the course of the legal proceedings the defendant invoked article 110 lit. 1 RCD, which was admissible.

Dr. Tobias Binser
German Patent and Trademark Attorney

Patent Attorneys
Vonnemann Kloiber & Kollegen
EUROPEAN PATENT ATTORNEYS
Edisonstraße 2
87437 Kempten (Germany)
T +49 (0)83 12 32 91
F +49 (0)83 11 77 15
kempten@vonnemann.de
www.vonnemann.de

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Finally, the bench did not follow the argumentation of the defendant that his alloy rims were solely for the purpose of repair of automobiles, mainly due to the fact that the defendant also marketed his alloy rims in sets of four alloy rims. For the bench it was quite unlikely that all four rims of an automobile in need of repair have to be replaced at once. In addition, the bench was of the opinion that especially alloy rims are not merely spare parts for automobiles, but rather independent products in the view of an extensive automobile tuning market. However, the bench allowed an appeal to the German Federal Court of Justice, which indicates that there is need for clarification. A corresponding appeal was actually instituted under the official reference BGH I ZR 226/14, but no decision is delivered so far.

No similar or identical restriction of design protection of spare parts as discussed above for the RCD is present in the GDA. Therefore, it is advisable especially for automobile manufacturers to apply for registration of German designs protecting the visible parts of their automobiles in order to avoid a process objection as outlined above. Due to other minor differences between the GDA and the RCD, which are beyond the scope of this article, the ideal way is to apply for registration of German and Community designs. In Germany a design double protection is admissible and yields the broadest scope of protection and therefore the best basis to successfully litigate potential design infringements.

Dr. Thomas Rinne
Partner

Rechtsanwälte Abogados
Goethestraße 7
60313 Frankfurt am Main
T +49 (69) 92 03 47 90
F +49 (69) 92 03 47 91 5
rinne@fra.einem.de
www.einem.de

v. Einem & Partner
Rechtsanwälte

Step by Step to Uniform Global Standards of Jurisdiction – the Hague Convention

What does a client await from his lawyer before litigation? Usually, that he predicts its outcome. But this becomes a difficult task, if the legal framework is unclear or fragmentary. The Hague Convention on Choice of Court Agreements could help to provide for more legal certainty in international litigation.

An ineffective choice of courts agreement can have fatal consequences. If a German entrepreneur readily assumes that, for example, a clause in its general terms and conditions determines the jurisdiction of German courts, he might be mistaken. His contractor might sue him before a court in the US, Mexico, China, or elsewhere. Costs and consequences of the process will be more than unclear and will certainly provide for distress within the next years. The same could happen to any company in the US that takes the validity of its choice of court clause for granted and sees it confronted with litigation in another country or even continent.

The European Union already has its set of rules on international jurisdiction. These are subject to EU law, at present the so-called "Brussels I Regulation (recast)". But in relation to third countries, there are no such uniform rules. In absence of other bi- or multilateral treaties, each country therefore consults its own rules on international jurisdiction. In the 90s, the Hague Conference on Private International Law has tried to create a multi-state agreement on jurisdiction and enforcement. This was in particular meant to govern the European-American transatlantic relationship. However, the Conference could so far only agree on rules governing choice of court agreements, the Hague Convention of 30 June 2005 on Choice of Court Agreements.

The Convention entered into force on 01 October 2015 in all EU countries (except Denmark). Nonetheless, there is a lack of further accessions to the convention. So far, only Mexico fully joined. The United States and Singapore could follow. From a European perspective, especially the United States would be more than welcome to ratify the treaty (i.e. transform it into national law), considering that they have already signed it in 2009.

Once more and more countries join the agreement, the convention will provide for more legal certainties in international commercial transactions. It does not only facilitate the assessment of the validity of a jurisdiction clause, it also facilitates the subsequent recognition and enforcement of a decision taken as a result of such a clause. Thus, the outcome of a legal dispute becomes naturally more predictable.

A powerful alternative to the convention, for instance in transatlantic economic relations, is an arbitration agreement. Especially companies negotiating contracts on a larger scale should consider this. The "Convention on the Recognition and Enforcement of Foreign Arbitral Awards" (aka “New York Convention”) applies in very respectable

Dr. Thomas Rinne
Partner

Rechtsanwälte Abogados
Goethestraße 7
60313 Frankfurt am Main
T +49 (69) 92 03 47 90
F +49 (69) 92 03 47 91 5
rinne@fra.einem.de
www.einem.de

v. Einem & Partner
Rechtsanwälte

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156 States worldwide. Arbitration awards are therefore recognized and easily enforced in these countries.

More or less uniform standards for reviewing jurisdiction clauses are also subject of the CISG ("United Nations Convention on Contracts for the International Sale of Goods"). This treaty after all has 83 contracting States. If, for example, a German and a US-American company seal a contract, this contract is - without express exclusion - governed by the CISG. The CISG does not contain explicit provisions on choice of court agreements. But it governs conclusion of contracts and the inclusion of general terms and conditions, which may also contain agreements on jurisdiction. The application of the CISG can therefore lead to divergent results in the effectiveness of choice of court agreements. For example, under German law it is sufficient, if the user of general terms and conditions refers to them and that they are perceivable (e.g. on the homepage of the user). However, according to the CISG such terms and conditions always need to be sent completely to the contractor. In such a case, easily the above-mentioned German company, which relies on the effective inclusion of choice of court clauses, could be referred to a court of jurisdiction in the US, and vice versa.

However, the CISG does not contain provisions for the enforcement of titles that are based on a choice of court agreement under the CISG. The EU therefore hopes for many States to sign and ratify the Hague Convention on Choice of Court Agreements in order to make another step towards international rules on jurisdiction and allow lawyers and businesses greater legal certainty.

Birgit Kurtz
Director, Business & Commercial Litigation Department
D +1 (212) 613 2009
F +1 (212) 554 9618
bkurtz@gibbonslaw.com

Gibbons P.C.
One Pennsylvania Plaza, 37th Floor
New York, NY 10119
www.gibbonslaw.com

Reform im US-Zivilverfahrensrecht soll Discovery Exzesse verhindern

Am 1. Dezember 2015 ist eine Reform für Zivilprozesse vor den U.S. Bundesgerichten in Kraft getreten. Erklärtes Ziel der Reform der Federal Rules of Civil Procedure („FRCP") ist die effizientere und damit kostengünstigere Gestaltung der „pre-trial discovery". Im Folgenden werden die wichtigsten Neuerungen und deren Auswirkungen vorgestellt.

Hintergründe der Reform

Durch die sogenannte „E-Discovery" – d.h. die Beweismittelerhebung in Bezug auf elektronisch gespeicherte Informationen, wie z.B. E-Mails – sind in den letzten Jahren Prozesskosten in Zivilverfahren extrem angestiegen. Es ist mittlerweile nicht unüblich, dass in einem handelsrechtlichen Zivilprozess mehrere Millionen E-Mails ausgetauscht werden müssen. Dies führt nicht nur zu höheren Anwaltsgebühren und erheblichen IT-Dienstleistungskosten, sondern beeinträchtigt auch den normalen Geschäftsablauf der betroffenen Unternehmen. Die neuen Regelungen sollen durch einen effizienteren, schnelleren und fokussierteren Ablauf des Zivilprozesses Abhilfe schaffen und ihn dadurch kostengünstiger machen.

Verhältnismäßigkeit

Die Neuregelung stellt das Verhältnismäßigkeitsprinzip in den Vordergrund. Gemäß FRCP 26(b)(1) (neue Fassung) muss die Discovery nun im Einzelfall verhältnismäßig sein, unter Beachtung folgender Kriterien:

- Streitwert
- Beweiserheblichkeit
- Belastung / Kosten durch die beabsichtigte Beweiserhebung und
- Voraussichtlichen Nutzen.

Zwar enthält die Zivilprozessordnung bereits seit vielen Jahren ein Verhältnismäßigkeitsgebot, aber das wurde bisher weitgehend ignoriert. Das Gebot wurde daher nun konkretisiert und stärker in den Fokus gerückt. Inwieweit die stärkere Bedeutung des Verhältnismäßigkeitsgrundsatzes Einfluss auf die Praxis haben wird, bleibt abzuwarten. Kritische Stimmen befürchten, dass dies zu neuen Auseinandersetzungen über die Bedeutung und Gewichtung der oben genannten Tatbestandsmerkmale führen wird.

Birgit Kurtz
Director, Business & Commercial Litigation Department
D +1 (212) 613 2009
F +1 (212) 554 9618
bkurtz@gibbonslaw.com

Gibbons P.C.
One Pennsylvania Plaza,
37th Floor
New York, NY 10119
www.gibbonslaw.com

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Reichweite der Discovery

Die Bestimmung, dass auch unzulässige Beweismittel von der Gegenpartei verlangt werden können, solange der Antrag „vernünftigerweise darauf zielt, an zulässige Beweismittel zu gelangen" („reasonably calculated to lead to admissible evidence"), wurde ersatzlos aus FRCP 26 gestrichen. Ziel ist, die Reichweite der Discovery klar auf solche Informationen zu beschränken, die für die Ansprüche und Einreden der Parteien relevant und in der Hauptverhandlung zulässig sind.

Sanktionen

FRCP 37 regelt u.a. mögliche gerichtliche Sanktionen im Fall der Verletzung der Discovery-Pflichten. Verschiedene Präzedenzfälle hatten in der Vergangenheit die Frage nach den Rechtsfolgen, die sich aus unerlaubter Löschung elektronisch gespeicherter Information (sog. „Spoliation") ergeben, unterschiedlich beantwortet und damit für Rechtsunsicherheit gesorgt.

Die neue Fassung von FRCP 37(e) soll diesbezüglich Klarheit schaffen. Danach kann das Gericht eingreifen, wenn eine Partei es versäumt hat, angemessene Schritte zur Erhaltung von elektronisch gespeicherten Informationen einzuleiten, und die dadurch verlorenen Informationen nicht wieder hergestellt oder anderweitig ersetzt werden können (z.B. wenn eine Partei E-Mails endgültig von ihrem Server gelöscht hat, die auch nicht aus anderen Quellen ersetzt werden können).

Wenn die Gegenpartei durch diese Löschung beeinträchtigt wird, kann das Gericht Maßnahmen anordnen, die geeignet sind, die entstandene Beeinträchtigung zu beheben, wie z.B.:

- bestimmte Tatsachen werden als bewiesen angesehen;
- bestimmte Beweismittel dürfen nicht verwertet werden; oder
- bestimmte Vorträge / Schriftsätze werden für unbeachtlich erklärt.

Schärfere Sanktionen kommen in Betracht, wenn eine Partei in der Absicht gehandelt hat, der anderen Partei elektronisch gespeicherte Informationen vorzuenthalten. In einem solchen Fall kann das Gericht gemäß FRCP 37(e)(2) (n.F.) folgende Sanktionen erlassen:

A. das Gericht kann annehmen, dass die gelöschten Informationen für die löschende Partei nachteilig waren (sog. negativer Rückschluss);

B. das Gericht kann die Geschworenen anweisen, dass sie annehmen dürfen oder müssen, dass die gelöschten Informationen für die löschende Partei nachteilig waren; oder

Birgit Kurtz
Director, Business & Commercial Litigation Department
D +1 (212) 613 2009
F +1 (212) 554 9618
bkurtz@gibbonslaw.com

Gibbons P.C.
One Pennsylvania Plaza,
37th Floor
New York, NY 10119
www.gibbonslaw.com

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C. das Gericht kann die Klage abweisen bzw. ein Versäumnisurteil erlassen.

Fazit

Vorschriften zur Eindämmung von E-Discovery Kosten waren schon lange überfällig. Ob die neuen Regeln ihren Zweck erfüllen werden, bleibt abzuwarten. Es ist aber wohl davon auszugehen, dass es in den nächsten Monaten und Jahren zu viel Unsicherheit und (teuren) Auseinandersetzungen über die Auslegung des Verhältnismäßigkeitsgebotes kommen wird.

Letters of Intent in German real estate transactions

Dr. Wolf zur Nieden
Rechtsanwalt/Assoziierter Partner
T +49 (221) 33 66 07 44
F +49 (221) 33 66 09 5
wzurnieden@goerg.de

Dr. Damian Tigges
Rechtsanwalt/Assoziierter Partner
T +49 (221) 33 66 07 88
F +49 (221) 33 66 09 5
dtigges@goerg.de

GÖRG Partnerschaft
von Rechtsanwälten mbB
Kennedyplatz 2
50679 Köln
www.goerg.de

In complex real estate transactions the parties often conclude so called Letters of Intent ("LoI") before they start the due diligence process and final negotiations. Although still very early into the transaction an LoI is setting the course to its successful completion. This is why one should be aware of which goals one should and which goals one should not pursue with this instrument.

Determination of the time schedule

Firstly, the parties simply indicate their interest to enter into more serious negotiations about the acquisition of the asset and determine the time schedule for the transaction process, i.e. the due diligence and negotiation phase as well as the date of conclusion and notarization of the sale and purchase agreement ("SPA").

Granting of exclusivity

As bidders understandably want to have certainty that their due diligence and negotiation efforts are not spent in vain, the parties often agree on exclusivity in favor of a bidder for a defined time period. Sometimes co-exclusivity will be granted to a (usually concretely named) number of bidders. Such approach is especially advisable in cases where there is a considerable risk that one bidder might try to turn negotiations in his favor by threatening to withdraw his bid, and, of course, in case that the transaction needs to be closed urgently and within a short timeframe.

The exclusivity generally provides the bidder with a certain security that the vendor will neither sell the asset to third parties, nor negotiate with third parties about its sale nor grant access to the data room to any third party during the respective time period. The vendor on the other hand gains certainty with regard to the scheduled timeframe.

To further ensure the vendor's interest in going forward only with serious bids and to conclude the SPA fast, the LoI may comprise sanction(s) against all too speculative bidders. For example, the vendor might demand a scheme in which the bidder needs to confirm the bid and his interest in the acquisition at one or several occasions during the process. If the bidder then fails to provide the required confirmation, the exclusivity phase may end and the bidder's entitlement to a compensation is revoked.

Indemnification for incurred expenses

An LoI is usually accompanied by indemnification provisions. In general, there are two models – sometimes applied in parallel: an indemnification for any complying bidder who has not acquired the asset at the end of the bidding process (often in combination with a co-exclusivity) and/or an indemnification in case of a breach of the exclusivity by the

Dr. Wolf zur Nieden
Rechtsanwalt/Assoziierter Partner
T +49 (221) 33 66 07 44
F +49 (221) 33 66 09 5
wzurnieden@goerg.de

Dr. Damian Tigges
Rechtsanwalt/Assoziierter Partner
T +49 (221) 33 66 07 88
F +49 (221) 33 66 09 5
dtigges@goerg.de

GÖRG Partnerschaft
von Rechtsanwälten mbB
Kennedyplatz 2
50679 Köln
www.goerg.de

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vendor, often to be paid in the form of liquidated damages. It is always advisable for the vendor to stipulate a concrete amount for the indemnification payment. This is because although this indemnification prima facie seems to protect the bidder, the vendor's liability without such a figure is – theoretically – unlimited and thus possibly higher.

Required form

In Germany, an SPA for real estate has to meet the statutory requirements of notarial form in order to be valid. Thus, the parties should pay attention that an LoI – if not notarized – does not contain a binding obligation to conclude the intended agreement. Otherwise, the entire LoI might become void, which usually does not correspond with the parties' intention. In this context, special attention should be paid to the indemnification provisions, because depending on the amount of the compensation it might be deemed to force the obligated party – usually the vendor – into the sale in order to avoid the financial loss of the compensation payment. Therefore, the compensation should always be in an adequate proportion to the offered purchase price.

Summary

An LoI may be a reasonable instrument to bind the parties during the due diligence and negotiation phases and create a reliable planning horizon. Yet, since the final agreement will not be binding before it is negotiated and worded into the final notarized document one should also not overestimate the influence an LoI will have on the material contents of the SPA. Thus, with regard to the consequences for the vendor an LoI should only be used as far as the market situation, the planned due diligence and negotiation phases as well as the economic value of the real estate make its conclusion seem reasonable. However, an LoI is neither an end in itself nor an instrument to finalize material agreements of the envisaged sale.

Andreas Maywald
Client Service Executive

Deloitte Tax LLP
30 Rockefeller Plaza
New York, NY 10112
T +1 (212) 436 7487
F +1 (212) 655 6989
C +1 (347) 819 3278
anmaywald@deloitte.com
www.deloitte.com

Transfer pricing documentation and country-by-country reporting: changes of the global transfer pricing landscape

The Organization for Economic Cooperation and Development (OECD) on October 5, 2015 released the final reports under the Base Erosion and Profit Shifting (BEPS) project it started two years ago to address perceived gaps in the international tax and transfer pricing rules. The final reports were submitted to the G-20 finance ministers at their meeting in Lima, Peru on October 8, 2015. The ministers endorsed the package of recommendations, which were then presented to and endorsed by the G-20 heads of state during their summit on November 15-16 in Antalya/Turkey.

The 186-page final transfer pricing report, which covers Action items 8-10, and the 70-page documentation and country-by country reporting provide guidance on a multitude of transfer pricing topics, including risk, intangibles, the role of contracts, and funding, and the new country-by-country reporting requirements. The final reports represents proposals to amend the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The OECD has not announced when it expects to formally adopt the recommended changes, but it is expected to occur soon.

The revised Chapter V of the Transfer Pricing Guidelines recommend that individual jurisdictions adopt a three-tiered approach to transfer pricing documentation:

- A master file with global information about a multinational corporation group, including specific information on intangibles and financial activities, that is to be made available to all relevant country tax administration;
- A local file with detailed information on all relevant material intercompany transactions of the particular group entity in each country; and
- A country-by-country (CbC) report of income, earnings, taxes paid, and certain measures of economic activity.

The new guidance will change the documentation process fundamentally and significantly increase MNE's transfer pricing compliance burden, because it requires most MNE's to gather and provide to the tax authorities substantially more information on their global operations than they have previously provided.

Master file

The master file should provide an overview of an MNE's global operations, its overall transfer pricing policies for the creation and ownership of intangibles and its financial

Andreas Maywald
Client Service Executive

Deloitte Tax LLP
30 Rockefeller Plaza
New York, NY 10112
T +1 (212) 436 7487
F +1 (212) 655 6989
C +1 (347) 819 3278
anmaywald@deloitte.com
www.deloitte.com

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activities, and its global allocation of income and economic activity to place the MNE's transfer pricing practices in their global economic, legal, financial and tax context.

Local file

The guidance requires that the local file contain much of the same information that was traditionally found in transfer pricing documentation related to the local entity, including its controlled transactions and financial data. Although the local file will be centered on a traditional functional and economic analysis, the guidelines are more prescriptive than the documentation rules in many countries, and require additional details not required or contained in many documentation reports. While the master file provides a high-level overview, the local file should provide more detailed information relating to specific material intercompany transactions.

Country-by-country report

As set forth in the guidelines, the final piece of the three-tiered documentation package should contain aggregate information for all entities and for each tax jurisdiction on the following items:

- Revenue by related and unrelated party and the sum, including royalties, service fees, interest income, premiums, and any other amounts derived from transactions with related or unrelated persons, excluding dividends;
- Profits before income tax;
- Income tax paid, including withholding taxes;
- Income tax accrued, that is, the sum of the accrued current tax expense recorded on taxable profits of the respective year, excluding reserves or deferred taxes or provisions for uncertain tax liabilities;
- Number of employees;
- Stated share capital;
- Retained earnings, and
- Tangible assets other than cash and cash equivalents.

The CbC report should provide information on each group member by tax jurisdiction, along with an indication of the jurisdiction of organization or incorporation, and relevant business activity codes for each entity, including dormant entities.

Andreas Maywald
Client Service Executive

Deloitte Tax LLP
30 Rockefeller Plaza
New York, NY 10112
T +1 (212) 436 7487
F +1 (212) 655 6989
C +1 (347) 819 3278
anmaywald@deloitte.com
www.deloitte.com

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The CbC report requirement applies to MNE's with annual consolidated group revenue in the immediately preceding FY of 750m or more.

The German MoF has already announced to implement the three-tier approach for German headquartered MNE's into domestic German tax law starting for FY's starting on or after January 1, 2016. Treasury and the IRS have stated that they are working towards implementation of CbC reporting in accordance with the OECD recommendation. The recently-released 2015-2016 Priority Guidance Plan includes an item for regulations under Internal Revenue Code Sections 6011 and 6038 relating to CbC reporting.

Elisa Fay, CPA
Partner

Rödl Langford de Kock LLP
Certified Public Accountants
Wirtschaftsprüfer, Steuerberater
1100 South Tower
225 Peachtree St., N.E.
Atlanta, GA 30303
D +1 (404) 586 3594
elisa.fay@roedlUSA.com
www.roedl.com/us

Dr. Will Dendorfer, CPA, StB
Partner

Rödl Langford de Kock LLP
Certified Public Accountants
Wirtschaftsprüfer, Steuerberater
747 Third Avenue, 4th Floor
New York, NY 10017
D +1 (212) 380 9220
will.dendorfer@roedlUSA.com
www.roedl.com/us

Rödl & Partner

Claiming U.S. Non-Resident Status for Income Tax Purposes When Holding a U.S. Green Card

Claiming non-resident status under the income tax treaty for U.S. tax purposes when holding a Green Card is not as simple as it seems. Certain filing requirements cannot be avoided despite the non-resident claim and in some cases serious tax implications may result.

Many individual taxpayers have applied for and received status as a U.S. Permanent Resident, commonly referred to as a "Green Card Holder". As such, these individual taxpayers are required under U.S. domestic law to file a U.S. income tax return (Form 1040) each year, reporting worldwide income and including any necessary informational returns. To the extent income tax was paid in non-U.S. jurisdictions that have an income tax treaty with the U.S. (such as Germany), the taxpayer is entitled to a credit against U.S. tax on that same income, subject to certain limitations.

Green Card Holders who spend considerable time outside of the U.S. (e.g., in Germany) frequently ask whether they can avoid to report their worldwide income (which includes their income from Germany) and pay only U.S. income tax on their U.S. source income. The answer is yes, but with certain risks as pointed out below.

The U.S./Germany income tax treaty overrides U.S. domestic law in the case where a person is deemed to be a resident of both the U.S. and Germany in the same tax year. In this case, the tie-breaker rules in Art. 4 of the U.S./Germany income tax treaty are used to determine residency for tax purposes. First, residency is determined based on where a permanent home is available to the taxpayer. If a permanent home is available in both places, residency is determined based on the person's "center of vital interests". If the person's personal and economic relations are closer in Germany (determined on a facts and circumstances basis), then the Green Card Holder may take the position that his/her center of vital interests is in Germany.

In order to take the treaty position, the Green Card Holder must file Form 8833 with Form 1040NR (U.S. non-resident income tax return), reporting only U.S. source (and not worldwide) income. There is a $1,000 penalty for failure to disclose the treaty position on Form 8833. In addition, the statute of limitations never begins to run and there is a risk that the IRS could assert that the Green Card Holder is a resident and require the return to be filed on such basis, if the treaty position is not claimed.

The U.S. non-resident treaty position does not extend to certain informational return filings, e.g., if the Green Card Holder owns investments in foreign (i.e, non-U.S.) companies and/or owns foreign bank accounts, certain life insurances or similar financial accounts or has signature authority on such accounts. In other words, the Green Card

Elisa Fay, CPA
Partner

Rödl Langford de Kock LLP
Certified Public Accountants
Wirtschaftsprüfer, Steuerberater
1100 South Tower
225 Peachtree St., N.E.
Atlanta, GA 30303
D +1 (404) 586 3594
elisa.fay@roedlUSA.com
www.roedl.com/us

Dr. Will Dendorfer, CPA, StB
Partner

Rödl Langford de Kock LLP
Certified Public Accountants
Wirtschaftsprüfer, Steuerberater
747 Third Avenue, 4th Floor
New York, NY 10017
D +1 (212) 380 9220
will.dendorfer@roedlUSA.com
www.roedl.com/us

Rödl & Partner

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Holder would still be required to file these informational returns even if claiming U.S. non-resident status under the treaty and filing Form 1040NR. The penalties for not filing the majority of these forms start at $10,000 per form.

Although this is a tax matter, it may have legal implications. It is possible that the U.S. Customs and Border Protection agency may learn about the Green Card Holder's treaty position claiming German residence as the center of vital interests. The Green Card Holder may be deemed to have given up his/her green card upon filing a non-resident return (Form 1040NR) or the immigration officer may revoke the Green Card, which in turn has tax consequences and therefore potentially subjecting the Green Card Holder to the U.S. Exit Tax.

Under the Exit Tax regime, all of a taxpayer's assets are deemed to be sold on the day before giving up the Green Card and – generally - the taxpayer is taxed on the gain in excess of an inflation adjusted amount of $690,000 (as of 2015), if certain holding period thresholds, income tax and net worth thresholds are met or if the taxpayer does not certify under penalties of perjury that he/she has complied with all of his/her tax obligations for the 5 preceding tax years. The Exit Tax will also apply if the Green Card Holder surrenders the Green Card or renounces U.S. permanent residence status.

Christopher Knipp
Senior Manager

RSM US LLP
1185 Avenue of the Americas
New York, NY 10036
D +1 (212) 372 1852
C +1 (646) 476 1628
F +1 (212) 372 1001
christopher.knipp@rsmus.com
www.rsmus.com

Ramon Camacho
Principal
International Technical Tax Lead
Washington National Tax

RSM US LLP
1250 H Street NW, Suite 650
Washington, DC 20005
D +1 (202) 370 8243
C +1 (703) 304 5526
F +1 (202) 370 8202
ramon.camacho@rsmus.com
www.rsmus.com

OECD issues BEPS final reports

After two years of work the OECD released a package of final reports from the base erosion and profit shifting (BEPS) project on October 5, 2015, which aims to combat perceived abuses of the international tax system. The OECD identified 15 action items and has worked on compiling recommendations to address each. If enacted by governments, the proposals will likely impact the operational structure and compliance obligations of multinational businesses. Below is a discussion of some of the key BEPS proposals.

Reinforced transfer pricing (TP) rules

The OECD's TP proposals will likely have the most significant impact on the compliance burdens of multinational companies. Under these proposals, taxpayers must maintain three new files:

- Master file that contains high-level information about their global operations
- Local file that contains information regarding related party transactions
- Country-by-country report that provides internal data in every country they operate.

Strengthened tax treaty provisions

The final report contains proposed revisions to current bilateral tax treaties' thresholds for nexus or permanent establishment (PE) status. Specifically, the OECD proposals would curtail the effectiveness of commissionaire arrangements to avoid PE status as well as limit the scope of various exemptions to PE status, including the preparatory and auxiliary and construction project exemptions.

The OECD's goal is to ensure the elimination of double taxation and avoid double non-taxation of income. To this end, the OECD has also proposed that countries adopt a limitations on benefits provision and an anti-abuse rule which are designed to limit tax treaty benefits to taxpayers for whom benefits were intended.

Addressing preferential tax regimes and special rulings

The OECD evaluated numerous preferential tax regimes and found 16 of those to be inconsistent with the BEPS objectives. The final report adopts a nexus approach to establishing valid tax regimes. Under this approach, countries may extend benefits to taxpayers that engage in significant economic activity in the local jurisdiction. In addition, countries subject to treaties with appropriate exchange of information articles are to begin exchanging information on preferential tax rulings issued on or after April 1, 2016, and they must exchange information regarding previously issued rulings by

Christopher Knipp
Senior Manager

RSM US LLP
1185 Avenue of the Americas
New York, NY 10036
D +1 (212) 372 1852
C +1 (646) 476 1628
F +1 (212) 372 1001
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December 31, 2016. Taxpayers that have received preferential rulings should assess whether these rulings may be scrutinized due to this OECD guidance.

Limiting benefits from hybrid entities and instruments

The final report includes model provisions to tackle hybrid mismatch arrangements that take advantage of the differences between two countries laws to create non-taxable income or double deductions. The OECD proposes that countries deny deduction for a payment that is not includible in the income of a counterparty in another country, or alternatively, that the recipient's country tax a payment that is deductible to the payor.

Other proposals

While the OECD did not propose that countries adopt controlled foreign company (CFC) rules, it provided recommended principles that countries may use should they decide to adopt new legislation or modify existing law. Furthermore, it is proposed that countries limit interest deductions based on either an individual fixed ratio or in conjunction with a group-wide ratio that would limit interest based on the overall debt of the worldwide group.

Addressing the digital economy

One of the overarching goals of the BEPS project was to address changes in business practices brought about by the growth of the digital economy and challenges to the VAT system. The final report recommends the implementation of VAT rules to ensure tax revenue is collected in the country where the consumer resides. The report also highlights the positive experiences of the several countries that have implemented simplified registration and reporting systems for VAT. In terms of the impact of the digital economy on BEPS, the final report generally identifies technical options available to address the challenges related to the allocation of taxing rights among countries.

Moving forward

The OECD proposals are broad and will have a significant impact on taxpayers with international business operations. Some or all of these proposals could be adopted quickly if governments adopt them through a multilateral instrument that implements BEPS recommendations and supersedes existing bilateral tax treaties. Taxpayers should carefully review their international tax positions to assess the continued viability of their planning structures and position if the BEPS proposals are adopted.

Maureen R. Monaghan
Senior Counsel

Wuersch & Gering LLP
100 Wall Street, 10th Floor
New York, NY 10005
D +1 (212) 509 6312
T +1 (212) 509 5050
F +1 (212) 509 9559
maureen.monaghan@wg-law.com
www.wg-law.com

WUERSCH & GERING LLP

The IRS Presumption Rules and the Withholding Certificate (Form W-8) Dilemma: A Solution for Foreign Partnerships Providing Services to U.S. Clients

Compensation paid to a nonresident alien or foreign entity for services performed outside the United States is not U.S. source income and is therefore not subject to nonresident alien/foreign entity withholding or FATCA withholding. Nonetheless, a U.S. payer may still be required to backup withhold at the rate of 28% on non-U.S. source payments if it does not receive a Form W-8 from each beneficial owner of the payment certifying his or her foreign status. This means that a foreign partnership (e.g., a foreign law firm) providing services to U.S. clients through a foreign office could be asked to provide a withholding certificate (Form W-8) from each individual partner in order to avoid backup withholding on the payment. For large partnerships with multiple offices this can present a daunting, if not wholly unrealistic, task. Fortunately, the U.S. Treasury Department has provided a solution to this problem by issuing regulations containing presumption rules that a U.S. payer must apply when it does not receive withholding certificate(s) from the beneficial owner(s) of a payment. By following the presumption rules, a U.S. payer may wholly avoid liability for tax, interest, and penalties when it does not obtain withholding certificate(s) from certain beneficial owner(s) of a payment.

The U.S. Accounts Payable Department Quagmire

Why is it so difficult dealing with U.S. accounts payable? A U.S. payer is required to apply the 28% backup withholding rate to a reportable payment made to a U.S. person (such as a payment for services made to a non-employee) if the U.S. payer has not received a valid U.S. taxpayer identification number from the payee. U.S. payers (and certain individual officers) are themselves held liable for the backup withholding tax that they incorrectly fail to collect if they do not precisely follow the IRS regulations. One way that liability for backup withholding may be avoided is by obtaining a valid Form W-8 from each beneficial owner of the payment certifying his or her foreign status. Thus, when making a payment for services to a foreign partnership, the legal department of a U.S. payor will typically instruct its accounts payable department to obtain a withholding certificate from each partner of the foreign partnership certifying his or her foreign status.

The Presumption Rules Pertaining to Partners of Foreign Partnerships

The IRS regulations provide that if a U.S. payer cannot reliably associate a payment with valid documentation, the U.S. payer must apply certain presumption rules in

Maureen R. Monaghan
Senior Counsel

Wuersch & Gering LLP
100 Wall Street, 10th Floor
New York, NY 10005
D +1 (212) 509 6312
T +1 (212) 509 5050
F +1 (212) 509 9559
maureen.monaghan@wg-law.com
www.wg-law.com

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order to avoid liability for tax, interest, and penalties. If the U.S. payer complies with the presumption rules, it is not liable for tax, interest, and penalties even if the rate of withholding that should have been applied based on the payee's actual status is different from that presumed. The presumption rules apply to determine the status of the recipient of a payment as a U.S. or foreign person and other relevant characteristics, such as whether the payee is a beneficial owner or intermediary, and whether the payee is an individual, corporation, partnership, or trust.

Temporary regulations that became effective for payments made on or after June 30, 2014 provide presumption rules for the determination of a partner's status as U.S. or foreign in the absence of documentation. These rules provide that so long as a foreign partnership provides a certificate certifying its foreign status, the individual partners of the partnership will be presumed to be foreign payees (assuming the U.S. payer does not have actual knowledge that any of the partners are U.S. persons). This means that a U.S. payor will not be held liable for backup withholding on payments for services made to a nonwithholding foreign partnership so long as the partnership furnishes a valid Form W-8 certifying its foreign status. Accordingly, by relying on the presumption rules, a U.S. payor can obviate the necessity of obtaining withholding certificates from each partner of a foreign partnership.

The real challenge for a foreign partnership, of course, is making this clear to U.S. accounts payable. The IRS regulations describing the documentation required from various foreign payees are exceedingly complex, which is why the accounts payable departments of U.S. businesses are instructed to obtain withholding certificates rather than determine when a withholding certificate may not be necessary. A foreign payee must therefore be in a position to pinpoint to the applicable regulatory authority if it believes it should not be required to provide a Form W-8.

Paula Firestone
Attorney at Law, Tax Manager

AugustinPartners LLC
INTERNATIONAL ACCOUNTING
AND TAX CONSULTING
300 East 42nd Street, 14th Floor
New York, NY 10017
D +1 (917) 472 5002
T +1 (212) 593 9900
F +1 (212) 593 9997
pfirestone@augustinpartners.com
www.augustinpartners.com

AugustinPartners LLC
INTERNATIONAL ACCOUNTING AND TAX CONSULTING

New York State Estate Tax Changes

New York State passed legislation that impacts the estate tax for those taxpayers subject to the tax. Prior to the legislation, New York State allowed taxpayers to leave their descendants up to $1 million dollars free of New York State taxes. Effective for April 1, 2014 and thereafter, however, the exemption (referred to in New York State law as the ***basic exclusion amount***) would increase by year to $5,250,000 for those taxpayers with dates of death on or after April 1, 2017 but before December 31, 2018. Taxpayers dying between April 1, 2014 and March 31, 2015 would be able to exclude $2,062,500 and those dying between April 1, 2015 through March 31, 2016 and April 1, 2016 through March 31, 2017 would be able to exclude $3,125,000 and $4,187,500 respectively. Starting in January of 2019 the exemption amount will be equal to the federal exemption amount and will be indexed for inflation. The top New York State estate tax rate remains at 16% under the new rules.

The law is very favorable for those taxpayers whose taxable estates are under the exemption amounts. However, there is a provision in the legislation that can lead to very unfavorable tax results. If an estate exceeds 5% of the maximum exclusion amount (referred to as the phase-out "cliff" amount), the taxpayer is taxed on the full value of the estate and not just on the amount in excess. For example if a taxpayer dies in 2014 when the maximum exclusion is $2,062,500, a taxable estate of more than $2,165,625 would trigger tax on the entire amount. Therefore, careful planning needs to be done, where possible, to ensure that the maximum exclusion amount is not exceeded for those estates that are close to the amount. Another planning device for spouses entails titling assets in such a way as to maximize each spouse's exemption amount.

Another drawback is that the New York State revisions do not include spousal portability whereby any exemption remaining unused upon the death of their spouse would be available to the surviving spouse in addition to their own exemption amount.

Lifetime gifts can help to reduce the taxable estate. However, the New York legislation also revised other areas dealing with tax and estate planning such as the gift tax. Whereas previously there was no gift tax in New York State, the legislation added a category of gifts that will be added back to the estate for New York resident taxpayers for gifts made on or after April 1, 2014. These gifts are those made during the three year period ending on the decedent's death. Gifts made by a resident or nonresident are not added back if the gifts consist of real or tangible property located outside of New York State. This "look back" provision prevents a formerly used planning tool of deathbed gifts to reduce New York taxable estates. Given the new rule, lifetime gifts are not a foolproof way of reducing the estate if death occurs in the three years after the gifts were given.

Susanne Gellert, LL.M.
Rechtsanwältin | Attorney at Law
Director Legal Department & Business Development Consulting

80 Pine Street, Floor 24 | New York, NY 10005
+1 (212) 974-8846 | +1 (212) 974-8867
legalservices@gaccny.com

www.gaccny.com