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EXPECTFOCUS®

LEGAL ISSUES AND DEVELOPMENTS FROM CARLTON FIELDS

PREPARING FOR CHANGE

MITIGATING THE IMPACT OF NEW POLICIES AND LEGISLATION

CARLTON FIELDS

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EXPECTFOCUS® International is a quarterly review of legal issues and developments related to international business, provided on a complimentary basis to clients and friends of Carlton Fields.

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Trends Against BITS and Investor State Dispute Resolution

BY ANDREW J. (JOSH) MARKUS

In my first *Expect Focus International* article (http://bit.ly/2G9Demu), I suggested that investors doing business outside the United States should do so in countries that have entered into bilateral investment treaties (BITs) with the United States. That is still good advice. However, there is a trend toward terminating BITs in various parts of the world, particularly in more authoritarian Latin American jurisdictions.

Ecuador is the latest to announce its withdrawal from BITs. It has terminated 12 BITs, including those with the United States, Spain, Argentina, Peru, and Bolivia. These terminations come on top of Ecuador's withdrawal from the International Centre for the Settlement of Investment Disputes (ICSID) Convention, which permits arbitration for various investment disputes. Ecuador is not the only Latin American country to take this step. Bolivia and Venezuela have also withdrawn from the ICSID Convention and from various BITs. Likewise, South Africa has terminated BITs, as have Indonesia and India.

These actions would have once been considered unusual. But now, the United States appears poised to follow suit. President Trump has withdrawn from the Paris climate accord and announced that he will renegotiate or withdraw from NAFTA. One U.S. criticism of NAFTA is its Chapter 19, which provides a binational dispute settlement process for challenging anti-dumping and countervailing duty measures. The U.S. aim is to completely eliminate Chapter 19. According to the U.S. administration's draft notice to Congressional leaders with respect to renegotiating NAFTA, "[Chapter 19] panels have ignored the appropriate standard of review and applicable law, and … aberrant panel decisions have not been effectively reviewed and corrected." Since NAFTA's implementation, the United States has been the target of 43 of the 71 matters heard by Chapter 19 panels.

The position of the United States and the nations that have terminated BITs appears consistent with a broader trend toward questioning investor state dispute resolution (ISDR) mechanisms, through which investors can sue countries for alleged discriminatory practices. In many instances, a country's withdrawal or threat to withdraw from a BIT or a treaty does not indicate a desire to cease participating in the treaty's protections, but rather is an attempt to renegotiate the treaty. This appears to be the case in India, Indonesia, South Africa, and the United States. Ecuador, additionally, has indicated that it intends to renegotiate from a position of equality or strength, which it lacked when the BIT was first negotiated.

Others throughout the world oppose ISDR. For instance, the International Federation for Human Rights opposes it on the grounds that it protects investor rights, not human rights. Others object that ISDR is conducted privately, not openly in the courts of one or the other country. However, without a BIT, an investor would have no legal recourse against the state in a court of law. In fact, one of the objections to ISDR voiced by certain governments is that it provides an additional channel for investors to sue governments, thereby eroding national sovereignty.

But is withdrawing from ISDR the wave of the future? In the revised version of the Trans-Pacific Partnership, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), Chapter 9 provides an ISDR mechanism. The 11 countries in the CPTPP, a treaty in which the United States. previously chose not to participate, have determined that the ISDR mechanism safeguards the valuable rights given to investors.

As I said in my first article, ISDR assures investors that the rule of law will protect their rights. No nation is forced to enter into a BIT. Nations typically welcome foreign investment. This method of dispute resolution facilitates such investment. BITs provide equal protection treatment for foreign investors that may not be honored in local judicial fora. BITs are not an unjust incursion on national sovereignty, but rather an agreed-upon procedure to ensure fair and equitable treatment.

New Tax Law Eliminates 30-Day Safe Harbor Against CFC Status

BY RAHUL RANADIVE

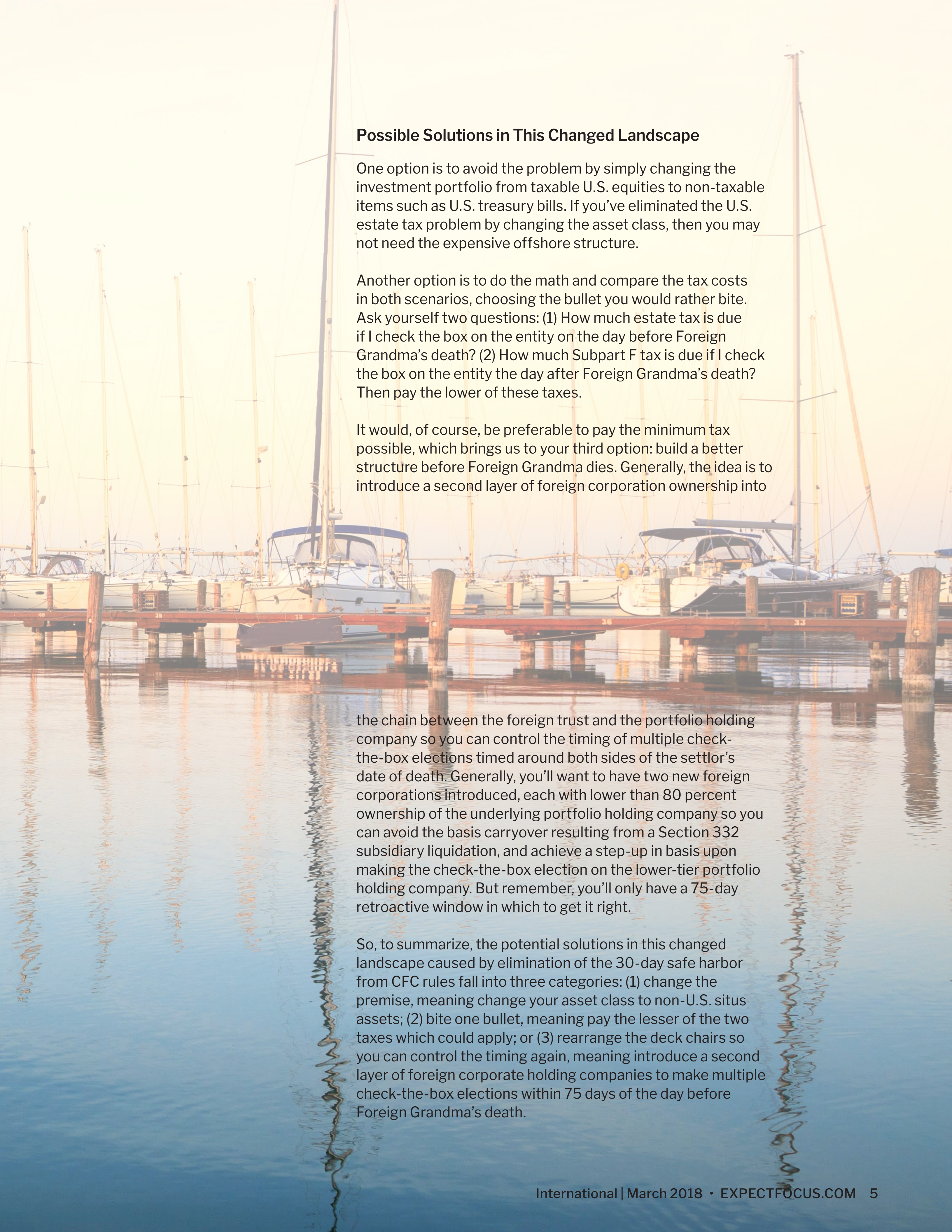
The recent tax law changes have focused primarily on corporate income tax, and in the international context, mostly on outbound tax matters. However, certain less publicized changes to the Code's controlled foreign corporations (CFC) provisions will have significant impact on inbound planning issues as well. This article focuses on one change that will greatly impact a traditional planning strategy used by wealthy non-residents who own U.S. equities they wish to leave, on their death, to one or more U.S. relatives.

Generally, a foreign corporation is a "controlled foreign corporation" if U.S. shareholders (i.e., U.S. taxpayers who directly or indirectly own 10 percent or more of the foreign corporation's stock) collectively own more than 50 percent of the foreign corporation's stock. Prior law provided a safe harbor against CFC status if the U.S. shareholders owned the requisite amount of stock for less than 30 continuous days during the year. In other words, if the U.S. ownership group owned more than 50 percent of the foreign corporation for less than 30 consecutive days during the year, they could avoid CFC status for the foreign subsidiary. The new tax act eliminates this 30-day exception rule so that CFC status is tested from day one, and tested every day of the year.

This change will have a large impact on a very common inbound inheritance planning strategy used by wealthy, senior generation non-residents who wish to leave their U.S. equity portfolio to their U.S. descendants. During the non-resident's lifetime, the U.S. equity portfolio would be owned by a foreign corporation, which would be solely owned by a foreign trust treated as a grantor trust owned by, and therefore taxable to, the non-resident. Upon the non-resident's death, the trust would convert into an irrevocable non-grantor trust of which the U.S. descendants would be the sole beneficiaries.

Under prior law, as long as the trust could make a check-the-box election within 30 days of the non-resident's death to treat the foreign corporation as a disregarded entity, U.S. beneficiaries could avoid CFC status. Further, the trust would be able to step up the basis of the U.S. equities as of the date of the election. Then, the trust could either liquidate the portfolio without recognizing significant gain, if any, and distribute the cash to the U.S. descendants, or simply distribute the portfolio to the U.S. descendants and let them sell or hold as they wished.

Now that the 30-day safe harbor rule has been eliminated, CFC status is tested immediately upon the non-resident's death. Accordingly, because of the ownership attribution rules, the U.S. descendants are treated as if they own the foreign corporation's stock held by the foreign trust. This means that a constructive liquidation through a check-the-box election (or an actual dissolution) after the non-resident's death leads to a CFC gain to the U.S. descendants, as does a distribution of the portfolio to them.



Possible Solutions in This Changed Landscape

One option is to avoid the problem by simply changing the investment portfolio from taxable U.S. equities to non-taxable items such as U.S. treasury bills. If you've eliminated the U.S. estate tax problem by changing the asset class, then you may not need the expensive offshore structure.

Another option is to do the math and compare the tax costs in both scenarios, choosing the bullet you would rather bite. Ask yourself two questions: (1) How much estate tax is due if I check the box on the entity on the day before Foreign Grandma's death? (2) How much Subpart F tax is due if I check the box on the entity the day after Foreign Grandma's death? Then pay the lower of these taxes.

It would, of course, be preferable to pay the minimum tax possible, which brings us to your third option: build a better structure before Foreign Grandma dies. Generally, the idea is to introduce a second layer of foreign corporation ownership into the chain between the foreign trust and the portfolio holding company so you can control the timing of multiple check-the-box elections timed around both sides of the settlor's date of death. Generally, you'll want to have two new foreign corporations introduced, each with lower than 80 percent ownership of the underlying portfolio holding company so you can avoid the basis carryover resulting from a Section 332 subsidiary liquidation, and achieve a step-up in basis upon making the check-the-box election on the lower-tier portfolio holding company. But remember, you'll only have a 75-day retroactive window in which to get it right.

So, to summarize, the potential solutions in this changed landscape caused by elimination of the 30-day safe harbor from CFC rules fall into three categories: (1) change the premise, meaning change your asset class to non-U.S. situs assets; (2) bite one bullet, meaning pay the lesser of the two taxes which could apply; or (3) rearrange the deck chairs so you can control the timing again, meaning introduce a second layer of foreign corporate holding companies to make multiple check-the-box elections within 75 days of the day before Foreign Grandma's death.

Employers Must Plan Ahead to Mitigate H-1B Visa Processing Delays

BY MARIA MEJIA-OPACIUCH

The Trump Administration has passed no new immigration legislation or regulation. However, the administration's stated focus on protecting the American worker, as articulated in its 2017 Buy American and Hire American Executive Order, has affected H-1B visa processing times to the detriment of employers seeking to either bring their best overseas talent to the United States, or to recruit qualified foreign nationals to work here. The bureaucratic slowdown is evident at the United States Citizenship and Immigration Services (USCIS) stateside, and at U.S. consulates that review work visa stamp applications overseas.

The USCIS and U.S. consular officers are issuing more requests for further evidence (RFEs) and requests for further information (RFIs) in connection with these visa petitions. In fact, USCIS statistics show that RFEs issued by the USCIS increased by 40 percent in the first three months of 2018. In some cases, the USCIS has taken to issuing two RFEs for the same petition.

Specialty occupation work petitions that could once be processed under premium processing in under 15 business days, can take three times as long when an RFE is issued. The USCIS has stated that the issuance of an RFE within the premium processing timetable meets the premium processing timing requirements. Employers are given 84 to 90 days to respond to the RFE. The USCIS can take an additional 60 days to review the RFE response, and then issue a decision.

Employers can take the following steps to alleviate the impact of these developments.

Plan Ahead

Review your company's staffing needs in the United States and determine the necessary skill set, education, and experience required to fill job openings at least 10 to 12 months in advance. This will allow you to gather the necessary documents from your foreign workforce. Early on, you should identify which foreign national employees working at the U.S. company pursuant to an F-1 student optional practical training (OPT) employment authorization document (EAD) card will need to have an H-1B specialty occupation visa processed to work beyond the OPT EAD card expiration date.

In addition to reviewing the job description and necessary education and experience, review the hierarchy of the position within the company, or at a more granular level, the department where the position will be housed to ensure that there is a particular position to be filled and that the identified foreign national can fill it. Identify the candidate early in the hiring process and review the CV, degree or diploma, and coursework to ensure that the candidate's education directly relates to the offered position. The USCIS has issued numerous RFEs in the past 12 months requesting a clear and full explanation of the duties to be performed and how the degree and coursework directly relate to the position.

Prepare the Documentation

We encourage employers to prepare the documentation regarding: the position; day-to-day professional duties broken down by the percentage of time needed to perform each; an in-depth description of the complexity of the professional duties to be performed; the coursework taken by the foreign national with a discussion of how it relates to the professional duties to be performed; and a full description of the required degree and how it directly relates to the professional duties to be performed. In some cases where the degree is not directly related to the position, we recommend that an expert opinion from either a university professor or employment agency head be included in the packet of supporting documents for the work visa petition.

Further, in 2017, employers faced RFEs related to using a low salary level on the legally required labor condition attestation (LCA) to be submitted with any H-1B work visa petition. The LCA must be certified by the U.S. Department of Labor. In 2017, employers typically used an entry level wage ("level 1"). The RFEs argued that an H-1B position could not be a "specialty occupation" if a level 1 entry level salary was being paid to the foreign national worker. This year, it is important for employers to articulate in any work visa petition that an entry level salary does not mean that the position is not a specialty occupation. After all, most professionals start their careers in what may seem to be entry level positions. A level 1 wage should not preclude the USCIS from finding that the position is an H-1B specialty occupation.

Process the Work Visa Petition Early in the Season

This year, it will be especially critical to have the work visa petition processed as early as possible with the USCIS offices. The position, its education and experience requirements, and the foreign national's skill set must be heavily documented and supported by a clear and detailed employer statement. This statement should be submitted to the USCIS early in the H-1B cap season to ensure that the H-1B petition is filed no later than March 30. The USCIS must receive the H-1B petition by April 1, which is six months in advance of when the U.S. government fiscal year begins, and the date the H-1B visa petition becomes effective.

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