

International Update

Tax Executives Institute

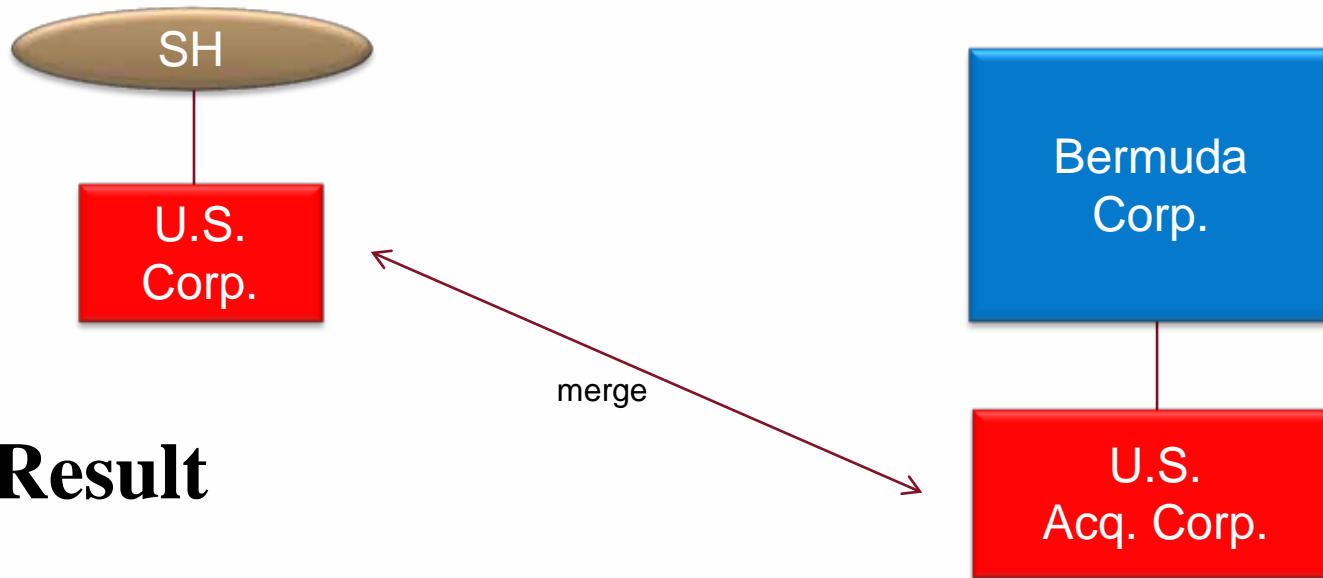


Joan C. Arnold ï April 22, 2014

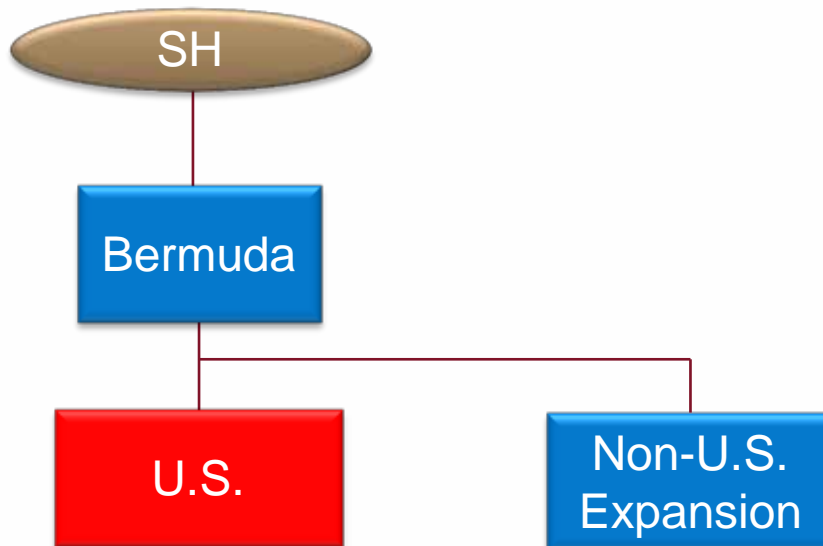


- Inversions - §7874 and merger mania
- BEPS – what is it and how will it affect you?
- Changes to accessing competent authority – welcome expansion, and impact on your IRS audit procedures

Inversion



Result



Inversions – How Did We Get Here?



- 1994, Helen of Troy, publicly traded U.S. corporation expatriated to Bermuda
- §367 regulations were amended to provide for shareholder level tax (generally) if
 - > 50% in vote or value of the stock of the foreign corporation was issued in the expatriation, or
 - the foreign corporation wasn't as large as the U.S. corporation (in value)

Impact Of The §367 Regulations



- Did not stop expatriations
- 19 publicly announced between 1999-2002
- Generally to Bermuda or Cayman Islands, but resident in Bahamas to be eligible for treaty benefits on dividends
 - Treaty benefits were repealed in 2005
 - Lots of proposed legislation that would have made Bermuda and Cayman Islands unattractive, so many of the 19 moved to Ireland or Switzerland

2003 – Enactment of §7874



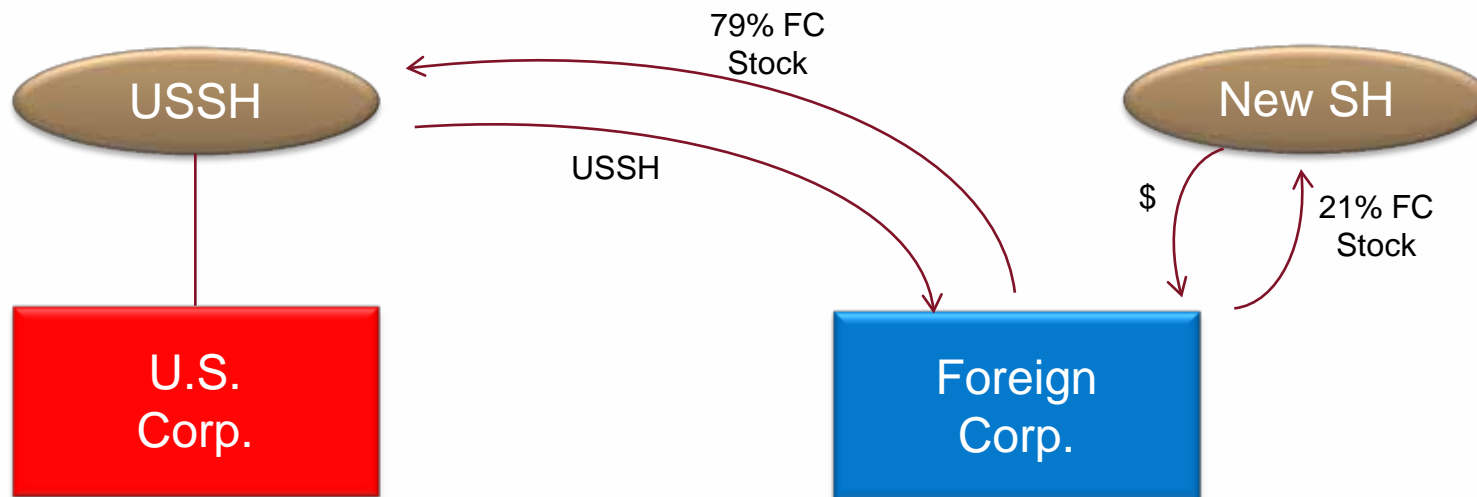
- If the shareholders of the U.S. corporation own 80% or more (vote or value) of the foreign corporation by reason of their ownership in the U.S. corporation, the foreign corporation is treated as a U.S. corporation for all federal tax purposes
- If ³ 60%, but < 80% of the foreign corporation stock is acquired by the “old” shareholders
 - U.S. corporation cannot use tax attributes to reduce “Inversion Gain”
 - Certain foreign source income is recharacterized as U.S. source for FTC purposes
 - §4985 imposes excise tax on stock compensation of certain officers and directors of U.S. corporation



- Does not apply if the foreign corporation has “substantial business activities in country of incorporation”
- Also applies to transfers of domestic partnerships that have U.S. trade or business
- Overrides all tax treaties

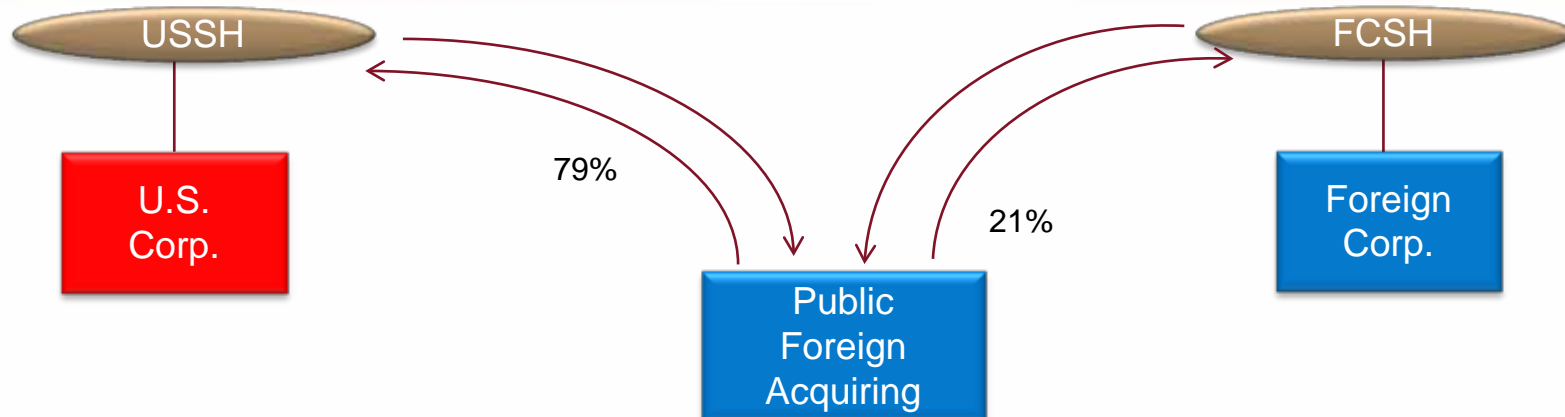
Determining “Ownership”

- Certain stock is not counted

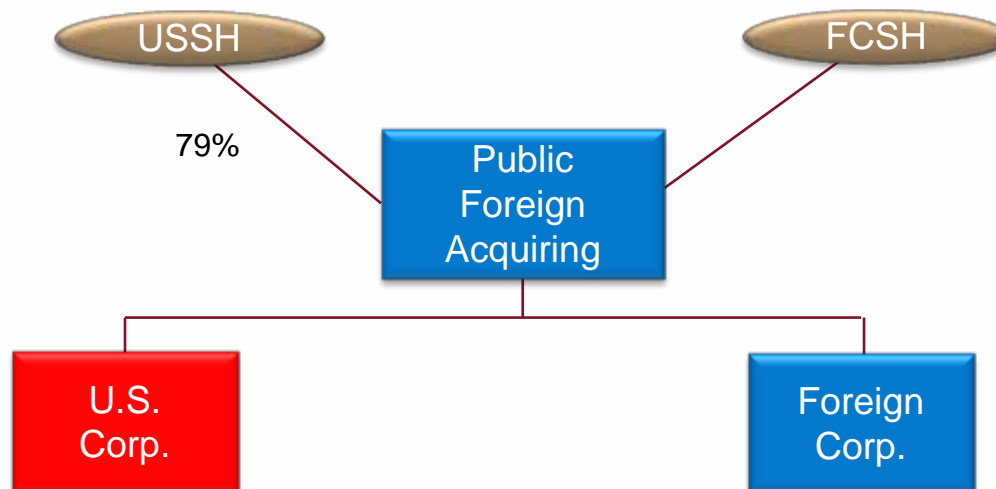


- If public offering, ignore stock held by new SH. §7874(c)(2)(B). USSH own 100% of Foreign Corp. and it is a U.S. corporation of U.S. federal tax purposes
- In private transaction, also ignore New SH because stock received for cash. Notice 2009-78. USSH own 100%
- Note: “USSH” means shareholders of the U.S. company, not shareholders of the U.S. company that are U.S. persons. USSH includes non-U.S. persons

Determining “Ownership”



Result



- Stock of publicly issued foreign corporation in a business combination is not disregarded, so no 80% inversion. Notice 2009-78
- Expanded to private companies in regulations

Determining “Ownership”

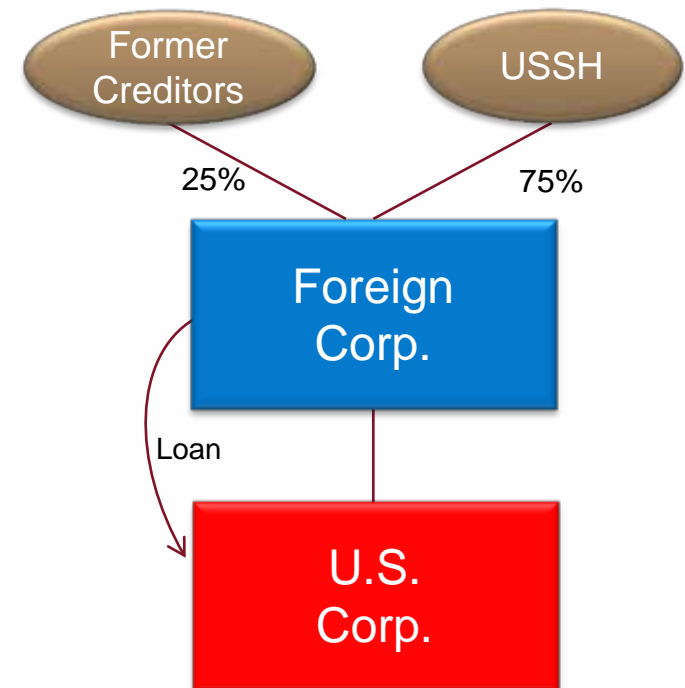
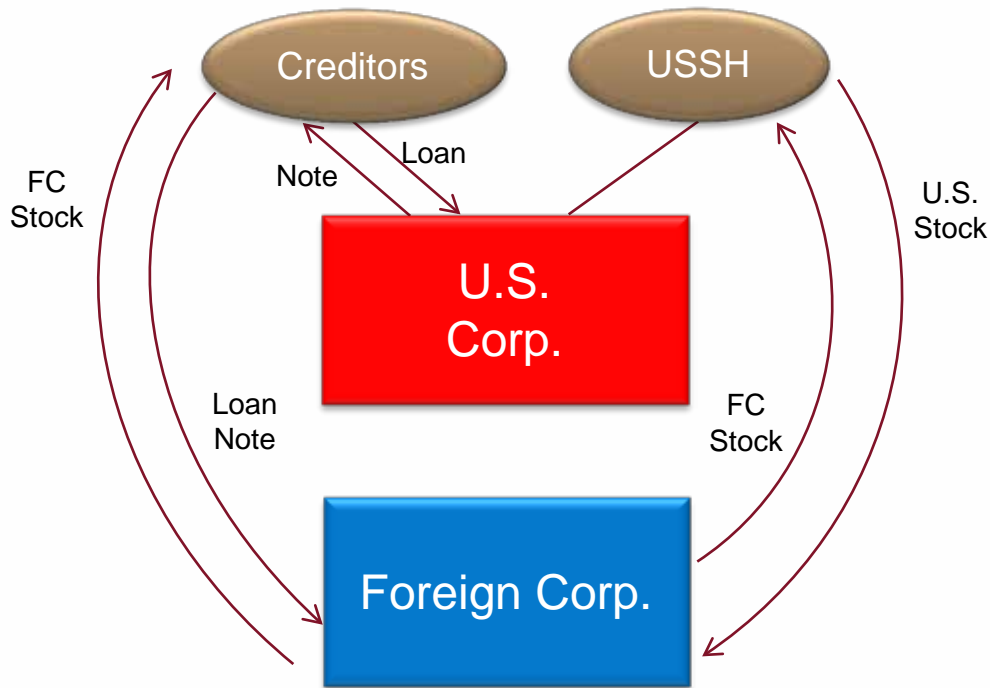


- Stock of the foreign corporation received in exchange for “non-qualified property” is generally disregarded for the ownership test
- Nonqualified property (Reg. §1.7874-4T)
 - Cash and cash equivalents
 - Marketable securities
 - Property in a transaction with a principal purpose of avoiding §7874
 - Disqualified Obligation (obligation of a member of the expanded affiliated group, former shareholders, or a related person)
- Doesn’t include stock of a corporation that becomes a member of the foreign corporation’s expanded affiliated group
- Only applies if the exchange is with the foreign corporation. SH to SH exchanges aren’t implicated

Treasury Regulation 1.7874-4T – Disqualified Obligations



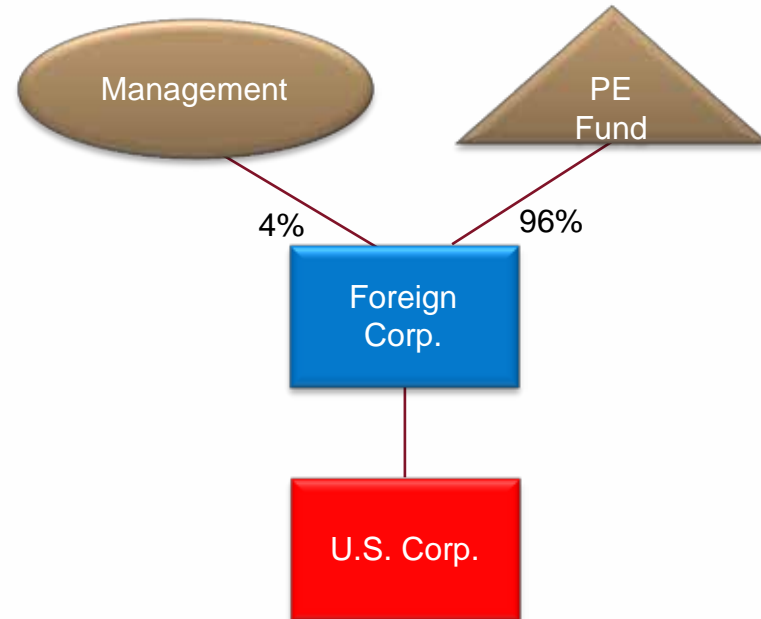
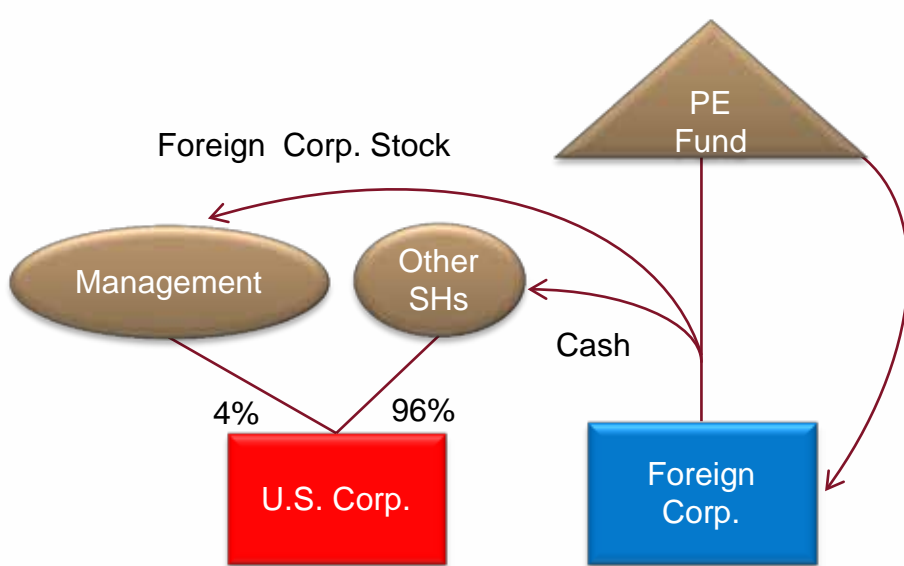
- Example 1: Stock of the Foreign Acquiring Corporation Issued to Creditors of Domestic Target



- Stock held by creditors does not count
- USSH own 100%

Treasury Regulation 1.7874-4T – *De Minimis* Exception

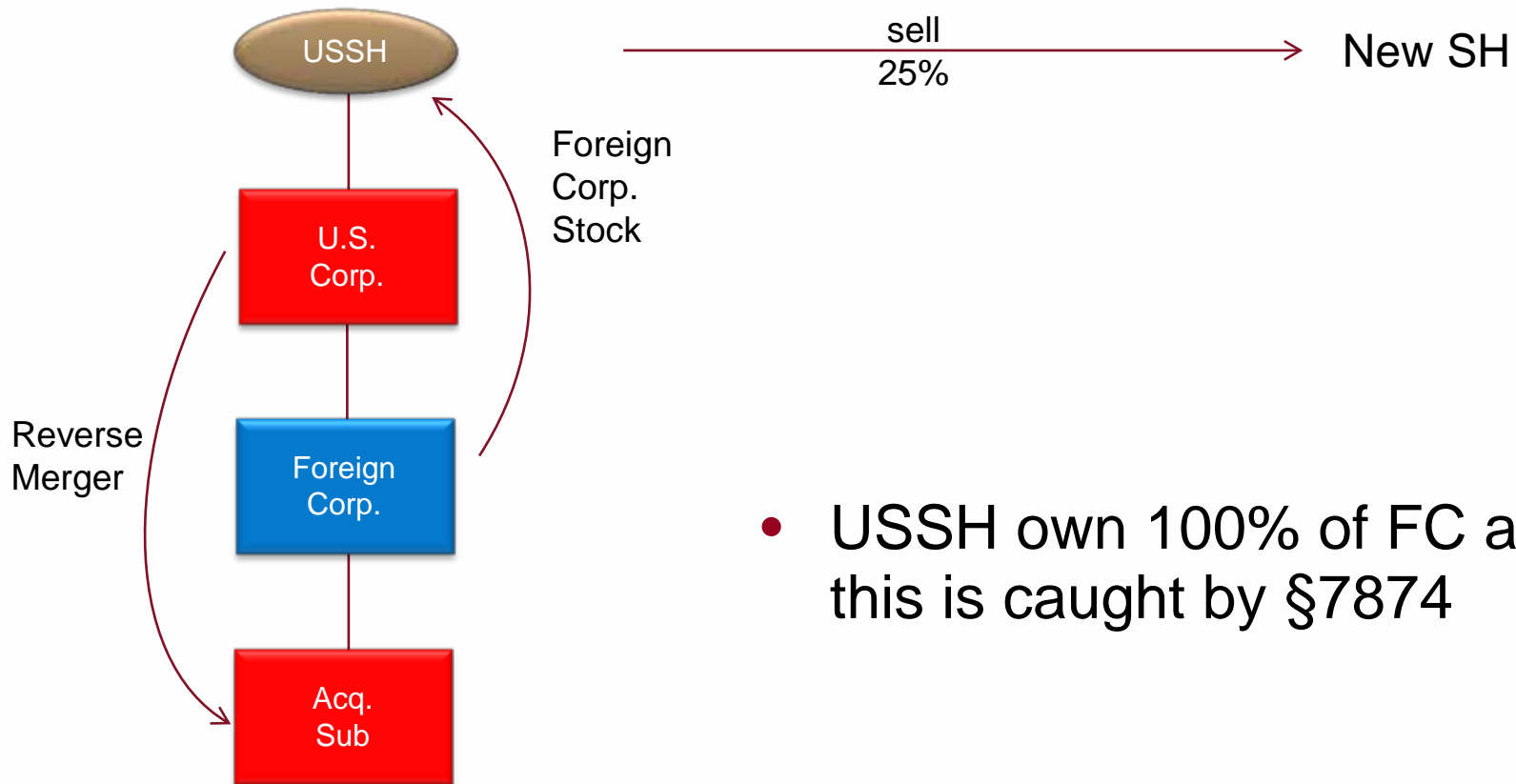
- The exclusion rule for disqualified stock does not apply if:
 - The ownership percentage would be less than 5%, and
 - After the acquisition and all transactions related to the acquisition, former shareholders of the U.S. Corp. own less than 5% of the stock of the foreign corporation or any member of the extended affiliated group



- Without *de minimis* rule, this would be an inversion at more than 80% continuing ownership

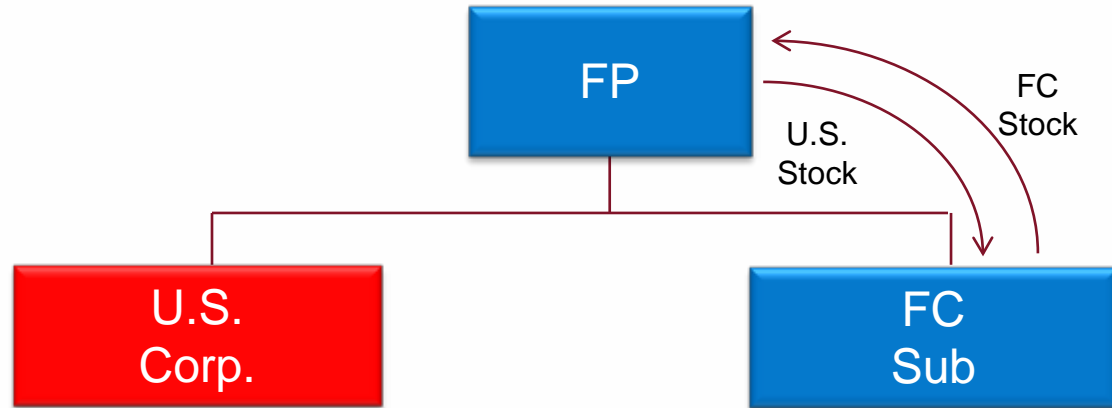
Subsequent Transfers 1.7874-5T

- Generally dispositions by USSH should not be taken into account



- USSH own 100% of FC and this is caught by §7874

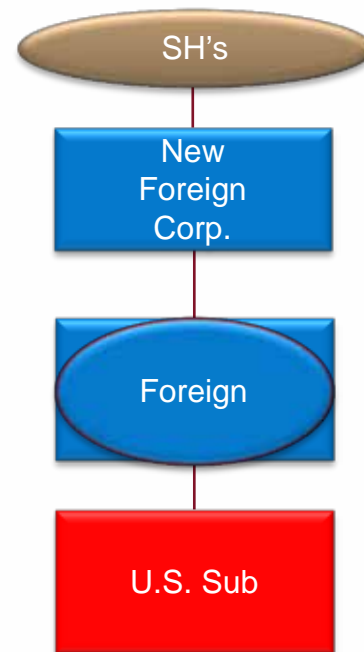
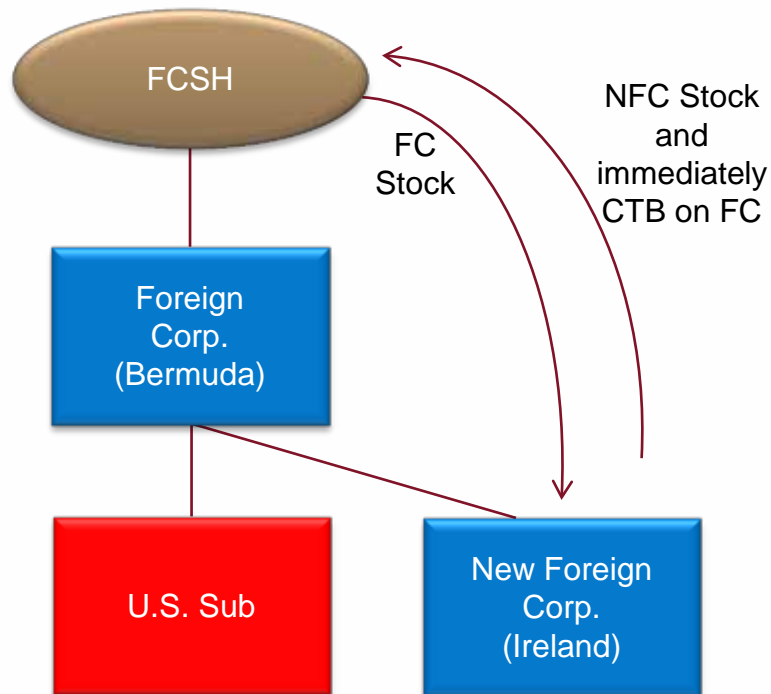
Internal Restructuring



- FP is acquiring stock of FC “by reason of its ownership of stock in U.S. Corp.”
- Both before and after the acquisition of the FC stock U.S. Corp. is owned > 80% by FP and therefore the ownership change is 0%. No inversion

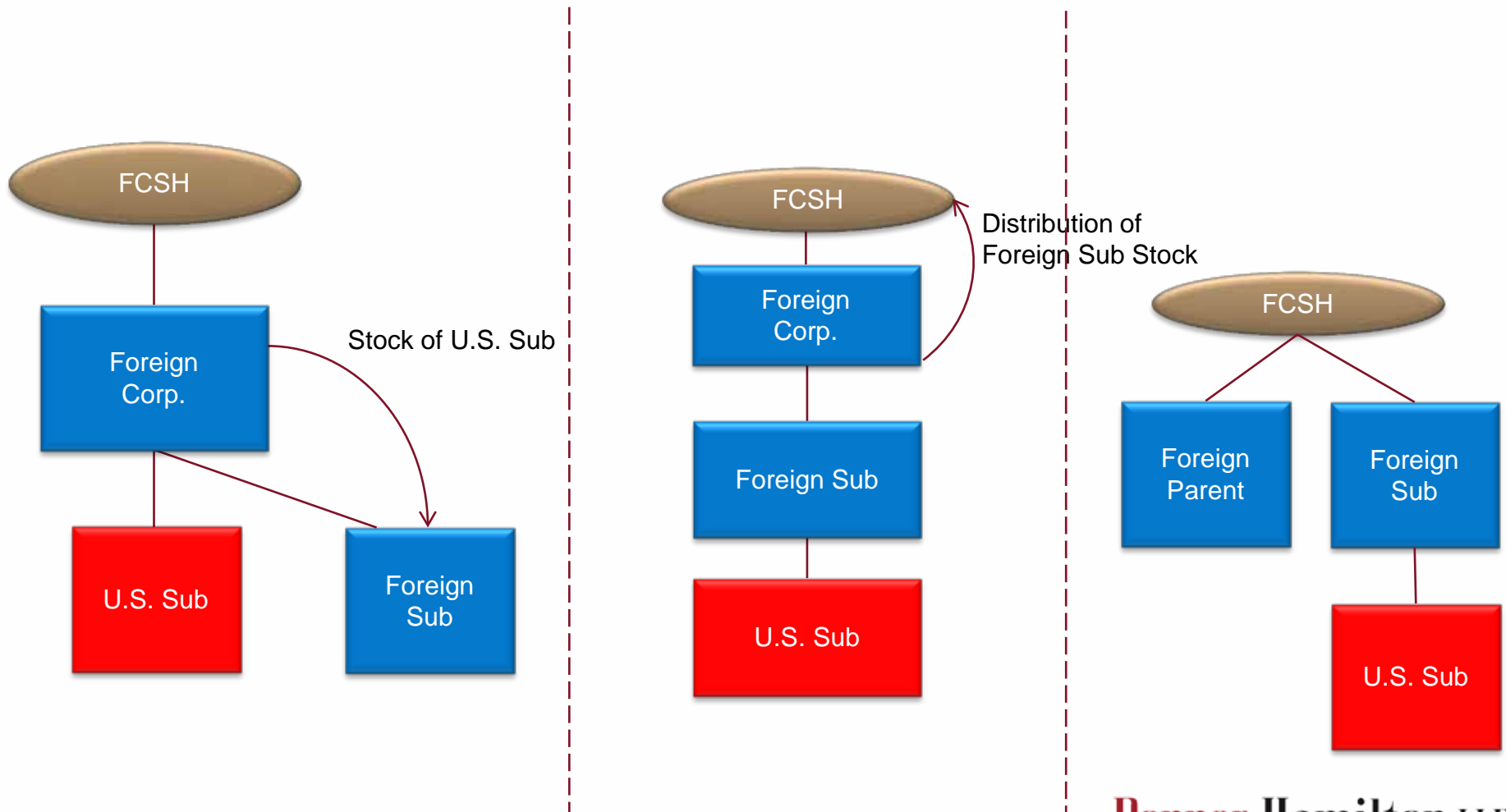
Subsequent Transfers of Stock & the EAG Rules

- Change place of incorporation of FC
- Foreign Corp. is deemed to transfer the stock of U.S. Sub to New Foreign Corp. in exchange for the stock of New Foreign Corp., followed by the distribution of New Foreign Corp. Stock to the Foreign Corp. shareholders in liquidation. “F” Reorg.
- Should Foreign Corp’s transitory ownership of the New Foreign Corp. stock be disregarded for purposes of the EAG rules?



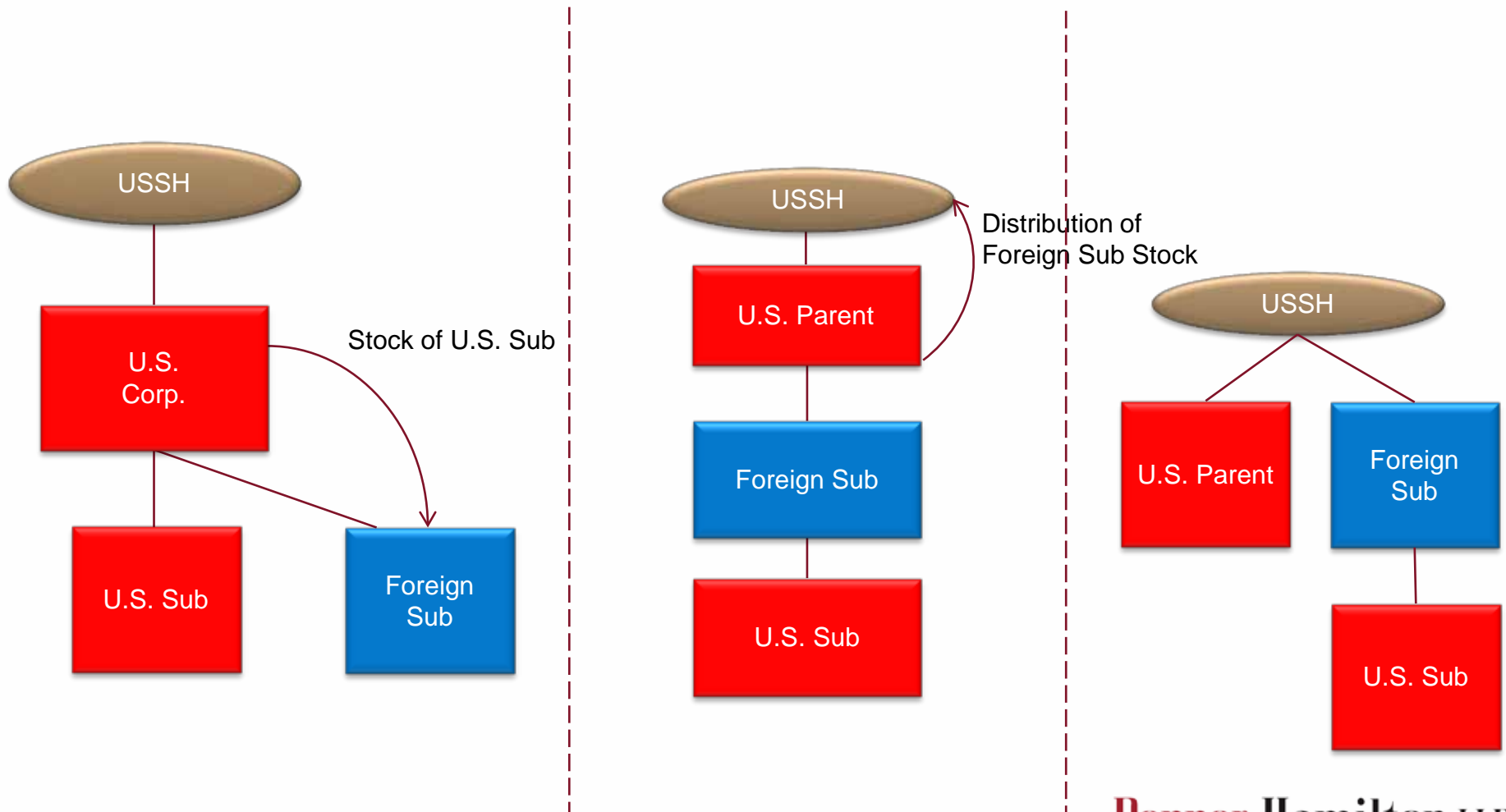
Subsequent Transfers & the EAG Rules

- Foreign parent contributes U.S. Sub to Foreign Sub and spins-off Foreign Sub



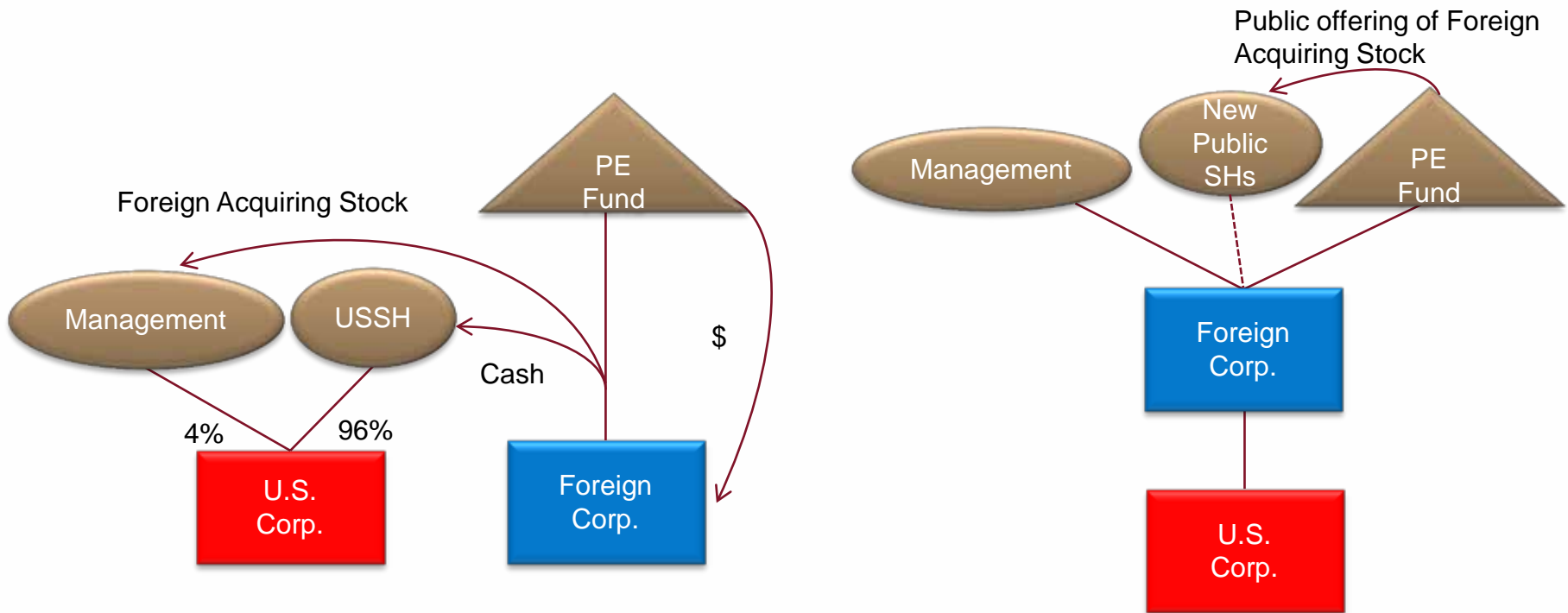
Subsequent Transfers & the EAG Rules

- U.S. parent contributes U.S. Sub to Foreign Sub and spins-off Foreign Sub



Subsequent Transfers and the *De Minimis* Exception: “Inversions over Time?”

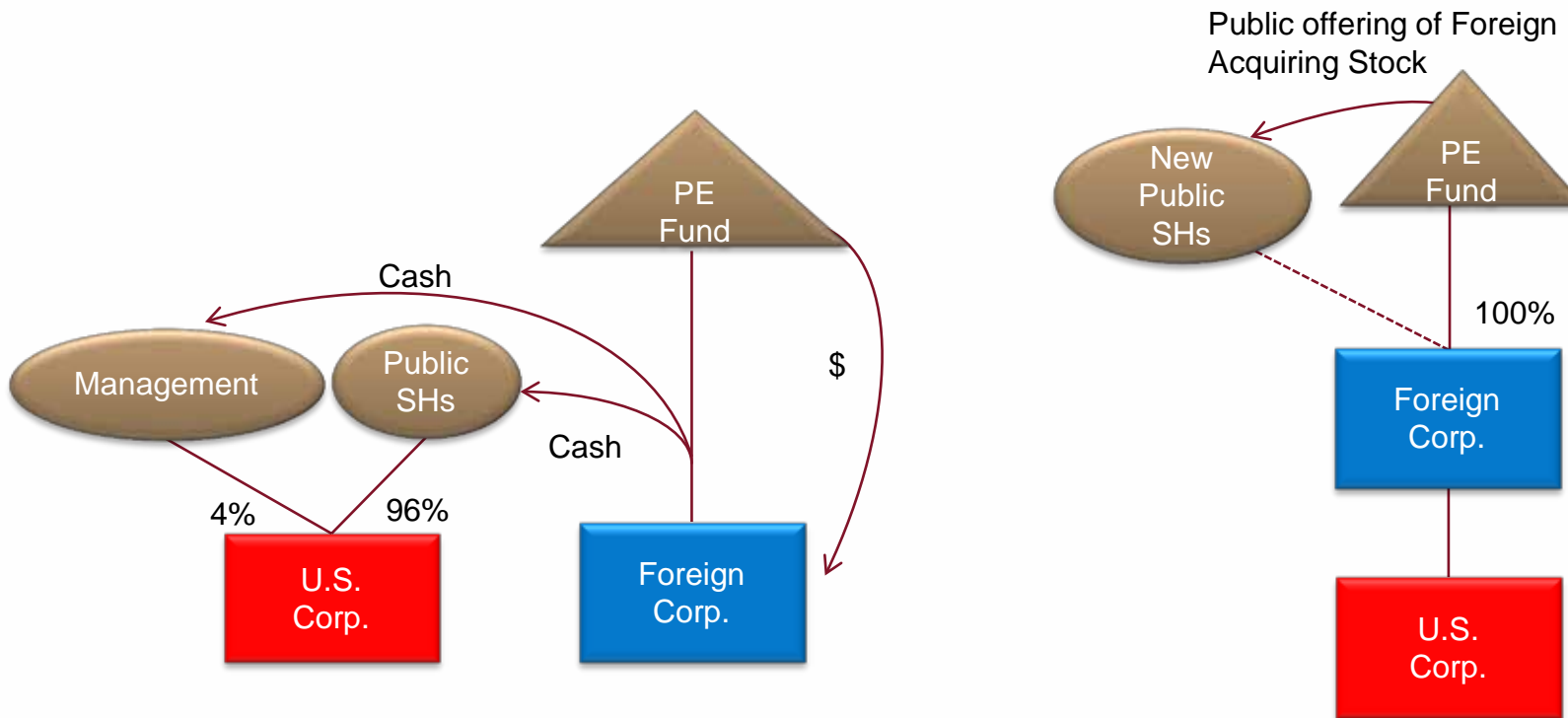
- A potentially troubling transaction: a subsequent public offering of foreign acquiring stock that was “one of the intended exit strategies of the buyer when it organized the foreign acquiring corporation to acquire the stock of the domestic corporation.”



Subsequent Transfers and the *De Minimis* Exception: “Inversions over Time?”



- Can this be an issue?

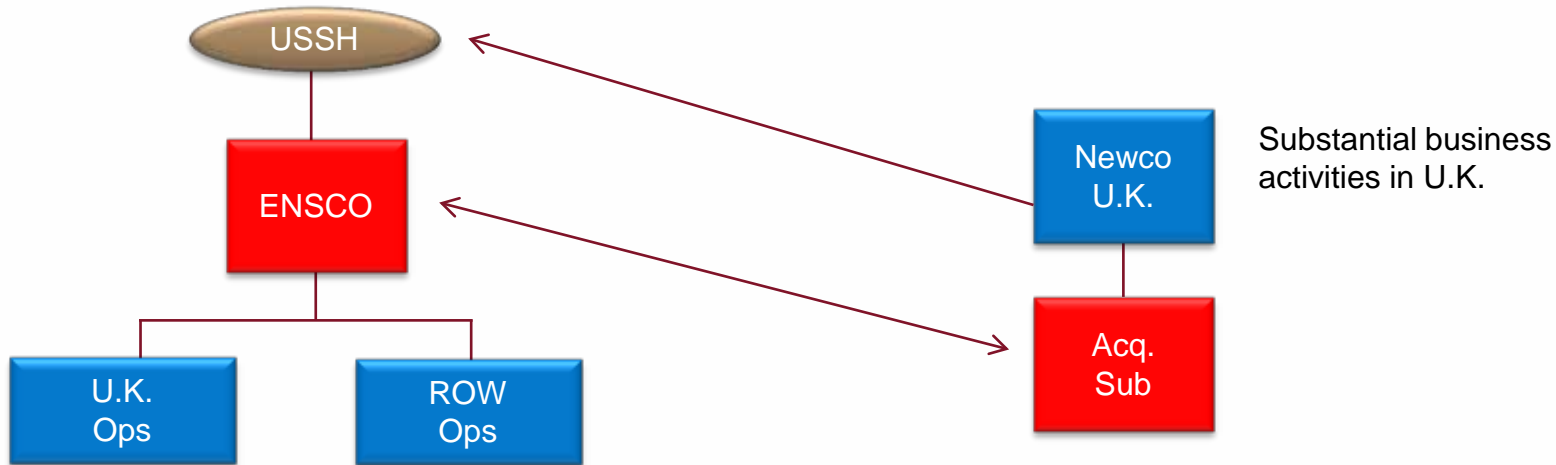


Substantial Business Activities

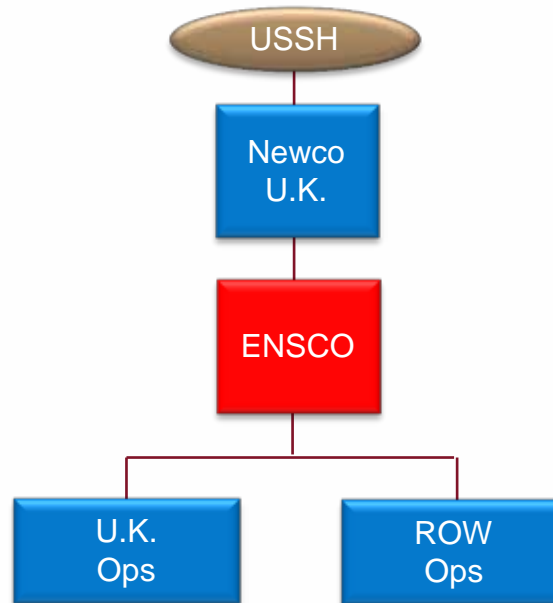


- Moving Target
 - June 2006 Regs – Safe Harbor: 10% in number and compensation of employees, value of tangible assets, sales
 - June 2009 – safe harbor removed, leaving only facts and circumstances test
 - June 2012 – bright line test of at least 25% of assets, employees and income. No facts and circumstances test

Post 2012 Migration - ENSCO



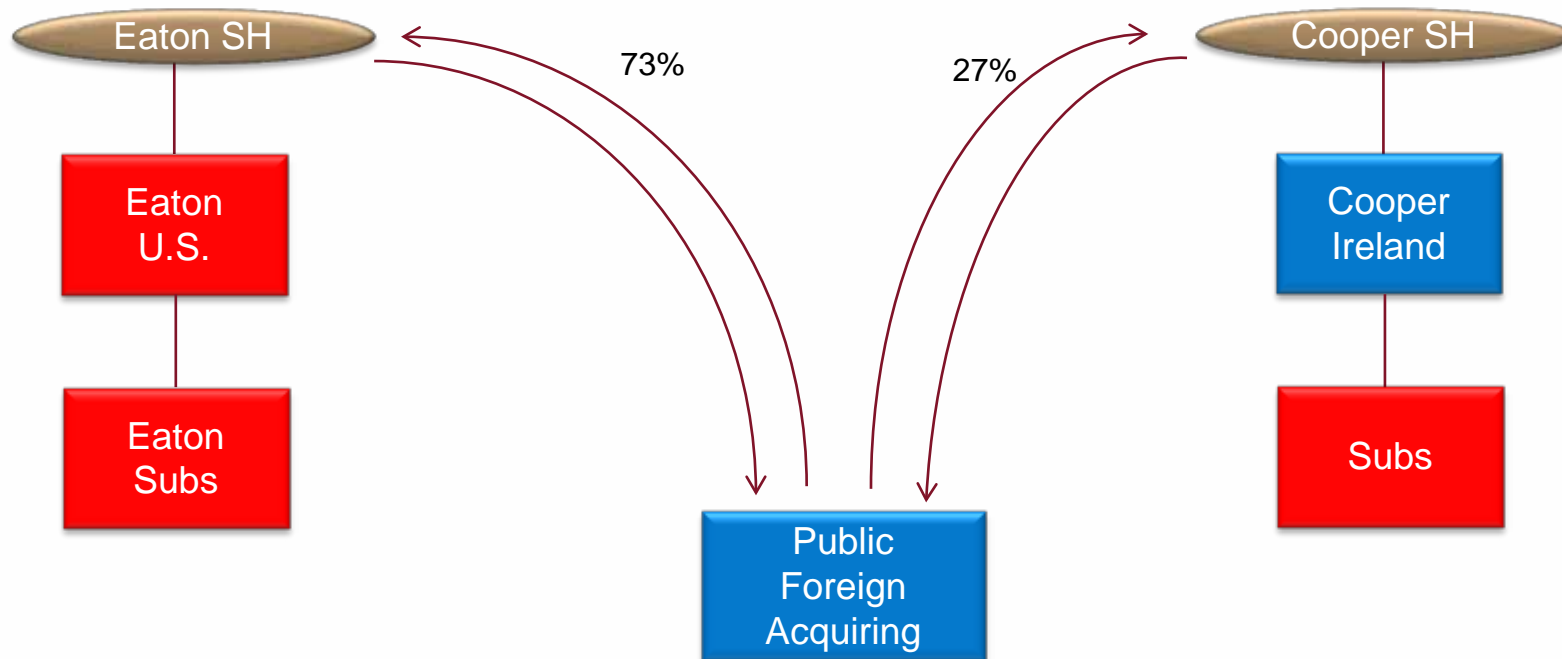
Result



- Not inversion, but SH subject to tax under §367

Inversion by Combination

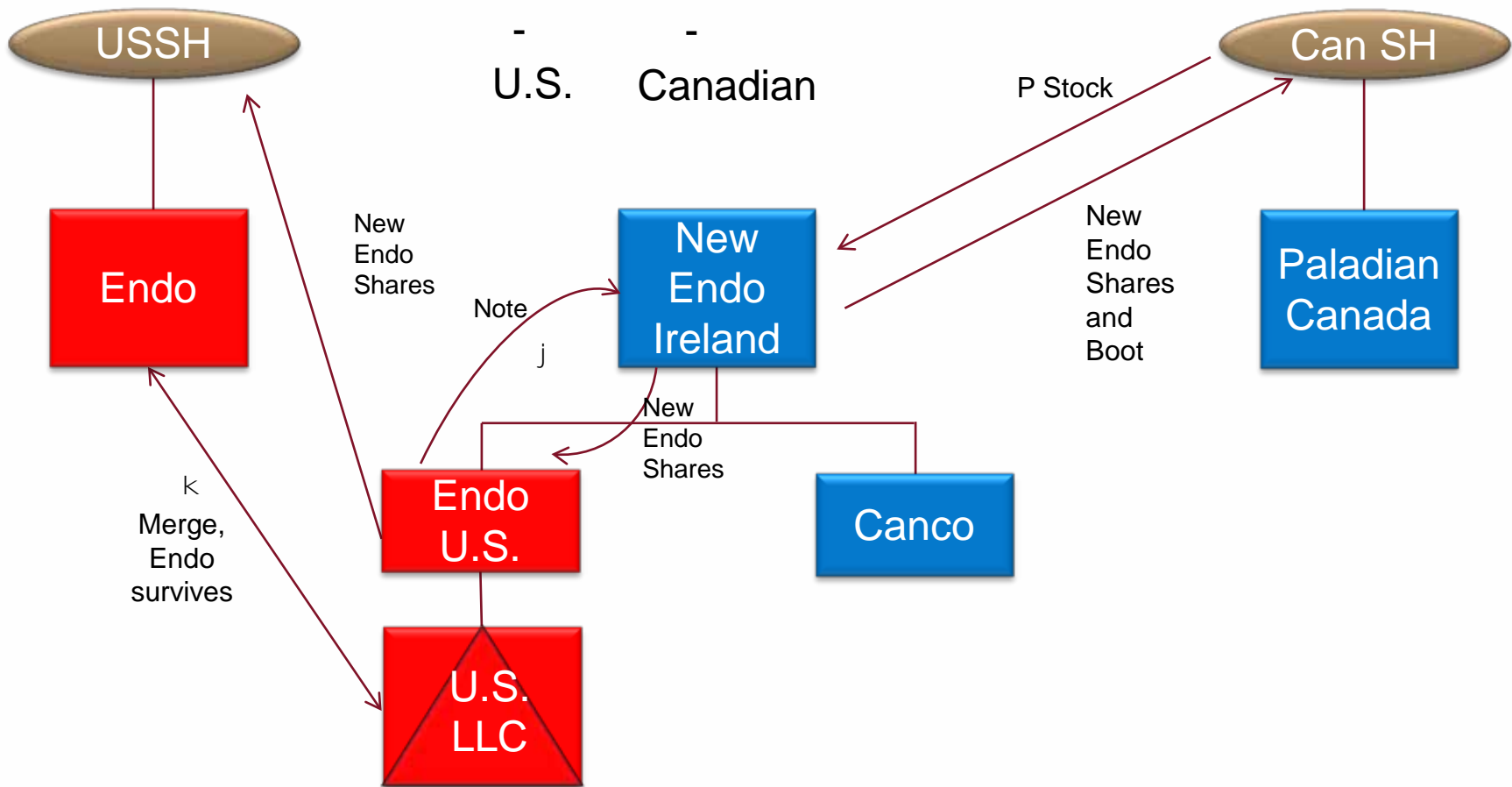
- Eaton/Cooper



- Cooper Ireland became a member of EAG in the transaction, so the 27% issued to Cooper SH counts, and Eaton SH owns less than 80% of Newco Ireland
- Eaton acquired Cooper, stated tax benefits supported the business goals

Does §367 Always Hit?

Endo / Paladian S-4 12/10/13



- USSH receive < 80%, so New Endo remains a foreign corporation
- S-4 says that this should be non-taxable to USSH



- §367(a) general rule is that if USSH receive > 50% of the stock, the gain is taxable
- Reg §1.367(a)-3(a) provides that if Reg. §1.367(b)-10 applies there is no gain taxable under §367(a)
- Reg §1.367(b)-10 applies, among other things, if you have a triangular reorganization in which the acquisition company acquired the stock of the parent for property
- Trade off is that there is a deemed dividend from Endo to New Endo Ireland that is subject to a withholding tax

Post Inversion Planning

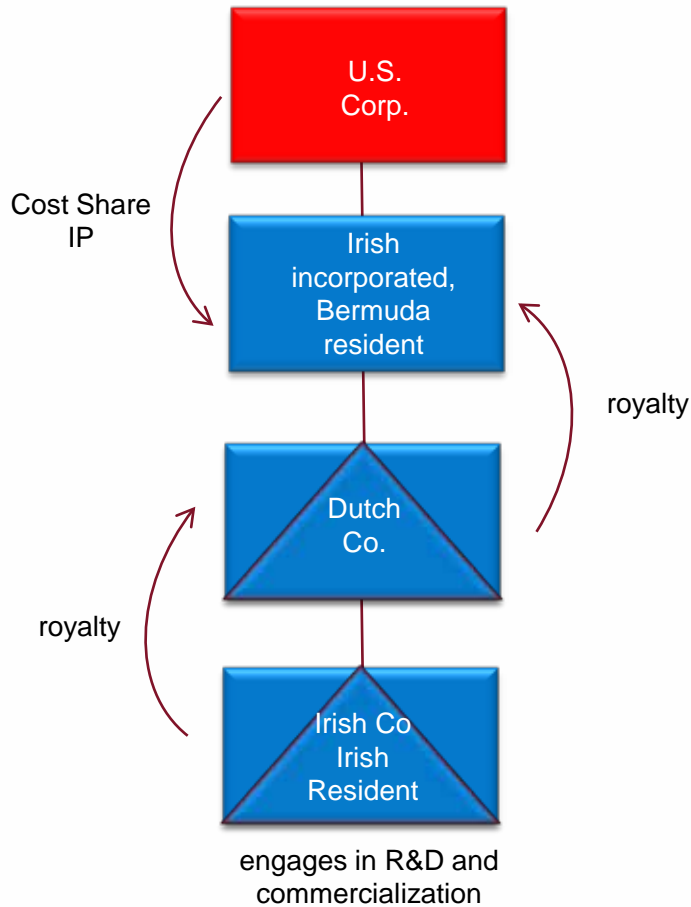


- Replace U.S. equity with debt. AKA –
 - “global cash management”
 - “capital structure planning?”
- Get out from under CFC rules. AKA –
 - “rationalizing foreign asset ownership”
- Modify supply chain structures
- See IRS’ response
 - Ingersoll Rand 2013 10-Q IRS challenged entire intercompany debt that arose in connection with expatriation to Bermuda
 - Tyco International (Tax Analyst Reporting) IRS asserting all intercompany debt is equity. At risk - \$6.6B in interest



- OECD project on Base Erosion and Profit Shifting
- Background
 - Global economy requires countries to collaborate on tax matters to protect tax sovereignty
 - Interaction of domestic tax rules and treaties can result in gaps and friction
 - BEPS relates chiefly to instances where the interaction of different tax rules leads to double non-taxation or less than single taxation
 - No or low taxation is not itself a cause of concern, but it becomes so when associated with practices that artificially segregate taxable income away from activities that generate it

Example



- Royalties don't exist for U.S. purposes because CTB, no Sub F income
- Active R&D and commercialization do not create Sub F income
- Dutch Co. needed for withholding tax on royalty
- Royalty is deductible in Ireland, creating an effective 2% Irish tax rate

- Inconsistencies
 - Check the box
 - U.S. views topco as Irish company, so activities in Ireland are good for Sub F qualification
 - Ireland views topco as Bermuda resident under "management and control," so no Irish tax

Actions Needed



- Bold move by policy makers is necessary to prevent worsening problems
- G20 finance ministers called on OECD to develop an action plan to address BEPS
 - provide countries with domestic and international instruments that will better align rights to tax with economic activity

About the OECD

- The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies
- The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.
- Note the G20 includes countries that are not a member of the OECD

15 Actions

1. Address tax challenges of the digital economy. September 2014
2. Neutralize effects of hybrid mismatch arrangements. September 2014
3. Strengthen CFC rules. September 2015
4. Limit base erosion via financial products. September 2015/December 2015
5. Transparency and substance to counter harmful tax practices. Final report December 2015
6. Prevent treaty abuse. September 2014
7. Prevent artificial avoidance of PE status. September 2015
8. Assure transfer pricing outcomes are in line with value creation – intangibles. September 2014/2015
9. Assure transfer pricing outcomes are in line with value creation – risks and capital. September 2015
10. Assure transfer pricing outcomes are in line with value creation – other high risk transaction. September 2015
11. Establish methodology to collect and analyze data on BEPS. September 2015
12. Require taxpayers to disclose aggressive tax planning arrangements. September 2015
13. Re-examine transfer pricing documentation. September 2014
14. Make dispute resolution more effective. September 2015
15. Develop a multi-lateral instrument. September 2014/December 2015

U.S. Approach to BEPS Project



- U.S. wants fairer policies, more transparency but objects to “blunt” instruments, which include
 - Digital permanent establishments
 - Main purpose of tax avoidance clauses in treaties
 - Broad anti-hybrid rules
 - Allocation of zero return to companies that fund intangibles and are located in tax havens
 - Formulary apportionment

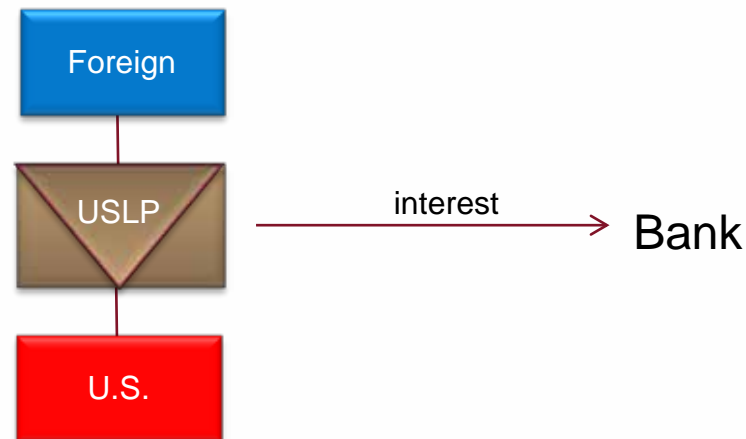
Hybrid Mismatches – Action 2



- Intended to drive taxpayers to less complicated and more transparent tax structuring that is easier for jurisdictions to address with more orthodox tax policy tools
- All countries should adopt same set of hybrid mismatch rules. OECD will draft model domestic laws to deny an exemption, deny a double deduction and establish rules for entity classification
- Change treaties to include beneficial ownership through hybrid entities

Hybrid Mismatches – Action 2

- Hybrid debt/equity instruments
 - source country should deny deduction or, as a secondary law,
 - receiving country should adopt a rule causing amount to be income
- Hybrid entities



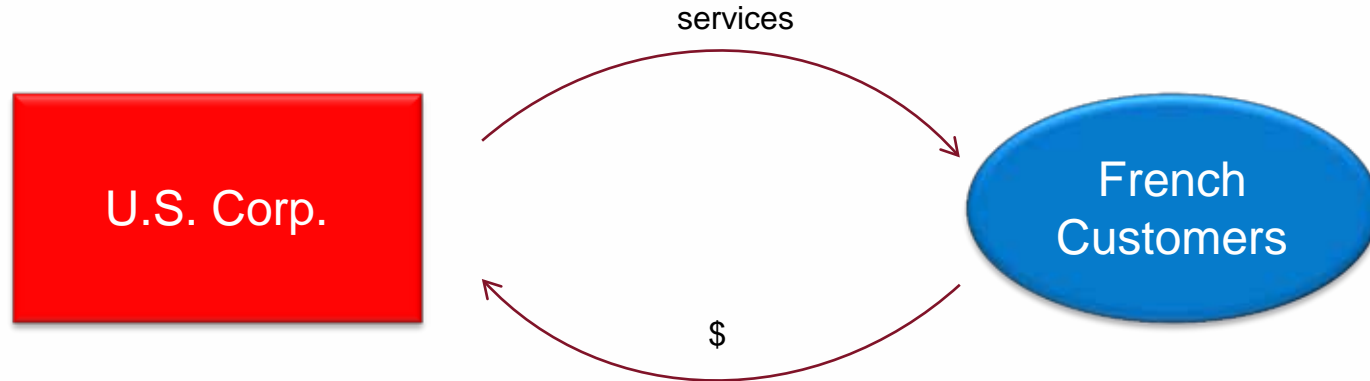
- Limit double deductions

Treaty Abuse – Action 6



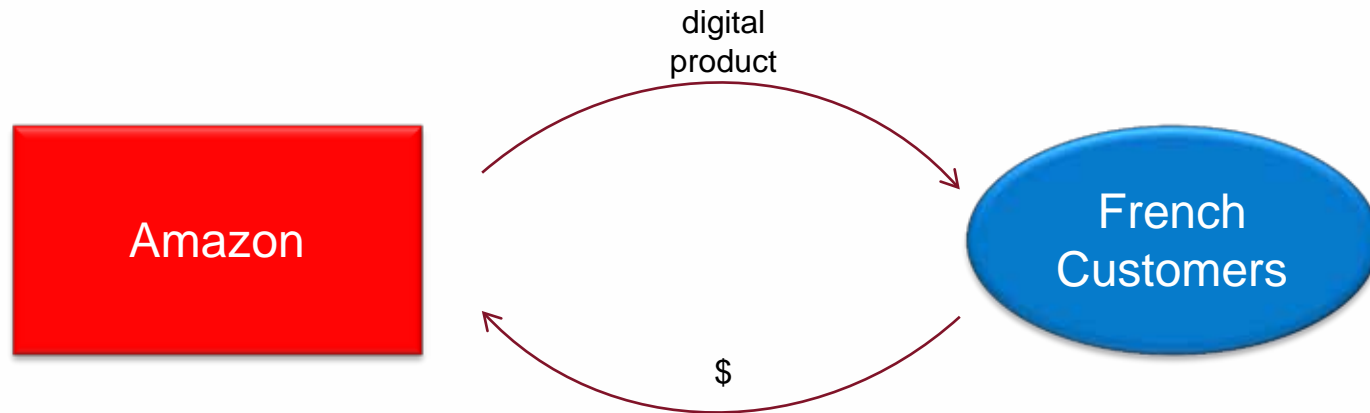
- Specific anti-abuse rule, loosely based on LOB in U.S. treaties
- Also suggests a “main purpose” anti-abuse test
 - deny treaty if under all facts and circumstances it is reasonable to conclude that obtaining the benefit was “one of the main purposes of entering into” the arrangement
 - See U.S. – Italy treaty
- Dual resident companies – competent authority to decide

Digital PE – Action 1



- Hires U.S. Corp. to perform analysis of business proposal
 - No French PE of U.S. Corp.
-
- What if French customer accesses U.S. Corp. server and runs the analysis. Any difference
 - What's the Minnesota answer?

Digital PE – Action 1



- No PE for Amazon in France?
- Concept of virtual PE was reviewed by OECD in the past and rejected. Business profits originate where actions are taken that allow the business to earn the profit, not in the market location
- Discussion draft does raise concern that a multinational is operating as a “single global firm”, which would undercut the separateness of corporations

Transfer Pricing Documentation – Action 13



- Recommends detailed, consistent collection of information via a template to be adopted
- Template is country by country (“CbC”) reporting of detailed information
 - Significant concern about confidentiality
 - Example: Sweden audited BP and in the course of that exam learned proprietary commercially sensitive information, which the tax authority relied upon to challenge a similar issue for Shell Oil. Court held that tax authority had to turn the information over to Shell so it could use it in its defense
- Asked for comments, received more than 1,000
- U.S. pushed hard to simplify the forms and to ensure it is not being collected to use as a basis for formulary apportionment

Cross Border Tax Disputes – Notice 2013-78



- Proposes significant changes in accessing competent authority to resolve cross border disputes (Rev. Proc. 2006-54)
- CA is within LB&I of IRS, and changes in LB&I group are driving significant changes in the CA process
- Beneficial change
 - Taxpayer initiated issues will be accepted
 - Example – U.S. corporation needs to decide how much of a cost it incurs is properly deductible by its German affiliate. Not yet an issue in Germany. If adopted, could request CA assistance before German audit

Notice 2013 - 78

- Now

IRS
exam



raises an
adjustment
that could have
impact in treaty
jurisdiction



adjustment
accepted

TP
makes
correlative
adjustment in
foreign
jurisdictions



TP is
denied
adjustment



TP seeks
USCA help

- Notice 2013-78

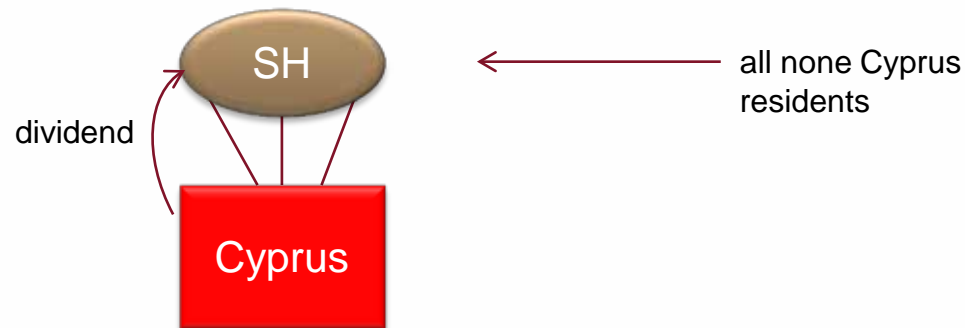
- Unless USCA is brought in before exam is closed, USCA will not assist in obtaining correlative adjustment



- If U.S. initiated adjustment is not accepted, and it goes to Appeals, must involve USCA shortly after Appeals begins, or be precluded from going to USCA for correlative assistance
- ABA Comments

Notice 2013-78

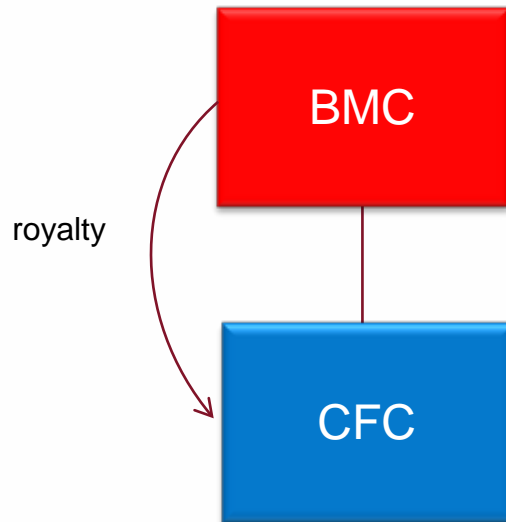
- Claiming benefits of a treaty under LOB when bright line tests not met – encouraged to call to discuss
- Issue of private law – USCA results are not public
- CCA 201343019



- Is dividend “qualified” for purposes of §1(h)(11)?
- LOB excuses 75% ownership requirement if no “principal purpose of obtaining treaty benefits”
- CCA based on representation

Transfer Pricing and Secondary Effects

- CFC paid dividend under §965 of \$721MM



- Years later, IRS finds royalty too high
- Under §482
 - deemed contribution by BMC to CFC, followed by dividend from CFC to BMC, or
 - Rev. Proc. 99-32 to set-up a/r with interest from CFC

Transfer Pricing and Secondary Effects



- Question – is the 99-32 A/R related party debt that counts when calculating the §965 benefits?
- Held – A/R under 99-32 are debt, not trade payables. Closing Agreement confirmed that they would be treated as debt, didn't address §965
- What's the impact for §965?

**For more information,
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