



Proposed US International Corporate Tax Reform: Impact on your tax planning

Luxembourg

22 September 2009

TAX



Any tax advice in this communication is not intended or written by KPMG to be used, and cannot be used, by a client or any other person or entity for the purpose of (i) avoiding penalties that may be imposed on any taxpayer or (ii) promoting, marketing or recommending to another party any matters addressed herein.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2009 KPMG S.à r.l., a Luxembourg private limited company and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative.

All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International

Introduction

- ◆ **On 4 May 2009, the Obama Administration released more details on its budget line-item for raising \$210B through international tax reform and enforcement, first referenced in its 26 February 2009, budget proposal.**
- ◆ **The proposal indicates that the international corporate tax revenue-raising provisions would generally be effective starting in 2011.**
- ◆ **The proposal includes three broad categories of tax revenue raisers aimed at multinational corps, but does not provide for a corporate tax rate cut.**
 - **Green Book extends SubPart F exceptions for look-thru rules and active financing through 2010.**
 - **Would apparently also keep worldwide expense apportionment.**

The Administration's Proposals

Three Prongs

- 1. Cut-Back Deferral – require companies to defer deductions for US-incurred expenses (except R&E) that support foreign investment until CFC earnings are repatriated (drawn from 2007 Rangel bill)**
- 2. Further Limit the Foreign Tax Credit – determine credit based on worldwide group taxes and income, tie the credit to US taxation of foreign earnings (drawn from Rangel Bill), and limit ability to separate income and taxes through, e.g., use of hybrid entities.**
- 3. Curtail Check-the-Box – require certain foreign entities to be classified as corporations**

White House 10-Year Revenue Estimates

Deduction Deferral:	\$60.1 B
Foreign Tax Credit:	\$43.0 B
Check-the-Box:	\$86.5 B
Withhold/Report:	<u>\$8.7 B</u>
Total	<u>\$198.3 B</u>

- ◆ The initially announced proposals were \$11.7B short of \$210B budget item.
- ◆ Further international tax revenue raisers included in Treasury Green Book proposals.
- ◆ The Joint Committee on Taxation's revenue scoring is significantly less than the White House's, particularly with respect to the proposed check-the-box changes

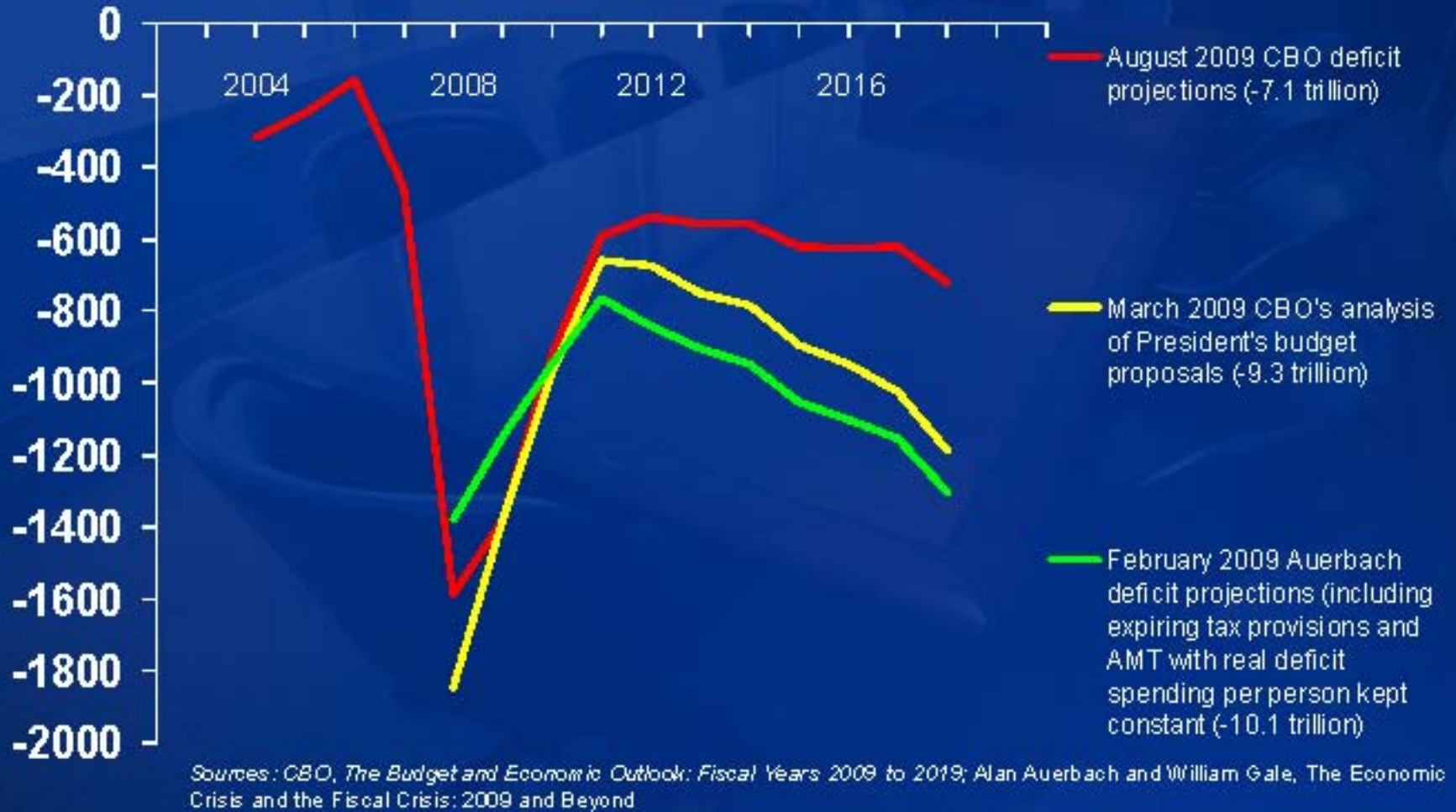
Additions in Treasury (Green Book) Proposals

- ◆ **Codifying economic substance**
- ◆ **Intangibles for outbound transfers from the US and transfer pricing “clarified” to include workforce-in-place, goodwill, and going concern value**
 - Plus, new valuation rules
- ◆ **Limiting “boot within gain” rule where foreign acquirer and dividend equivalent (e.g., all cash “D” reorganizations)**
- ◆ **Repealing 80/20 rules**

What Happens Next

- ◆ **The budget process and the role of Congress**
- ◆ **Political background**
- ◆ **Potential alternatives for deferral reform**
 - Repeal of deferral, Subpart F reforms, etc.
- ◆ **Timing issues**

Fiscal picture - *Total Budget Deficit (\$b)*



Deduction Deferral (Sec. 975 of Rangel Bill)

- ◆ Foreign Related Deductions (“FReDs”) – defined as total deductions that would be allocated/apportioned to gross FSI if both current and deferred FSI were taken into account
- ◆ FReDs can only be deducted in a current year in the same ratio that current FSI bears to all FSI (both current and deferred)

$$\text{(FReDs)} \times \frac{\text{(Current FSI)}}{\text{(Current FSI + Deferred FSI)}} = \text{Allowable Deductions}$$

- ◆ Note that deferred FSI is as if “Subpart F” (which is a net income number), while current FSI is gross income

Deduction Deferral (continued)

◆ FReDs

- Administration proposal would carve out R&E expense
- Interest
 - Joint Committee Report (“JC Report”) notes that proposal must be matched with worldwide apportionment to prevent “overcorrection”
- SG&A
- Foreign Branch Expenses
 - JC Report notes ambiguity; indicates that excluding branch expenses may be appropriate
- Other Expenses Directly Allocated to FSI

Deduction Deferral: Interest Expense



- ◆ Assets = 60% US / 40% foreign.
- ◆ Under current law, USCo apportions the \$100 of interest expense \$60 to USSI and \$40 to FSI.
- ◆ Under the Rangel bill, 50% of total FSI is deferred. Therefore, \$20, or 50% of the \$40 foreign-allocated interest expense, is deferred.
- ◆ Unclear how the deduction deferral affects the section 904(a) limitation – is the deferred interest all allocable to FSI, or is the currently allowable amount (\$80) the amount that is subject to apportionment?

FTC Changes (Administration Proposal)

◆ Three main principles

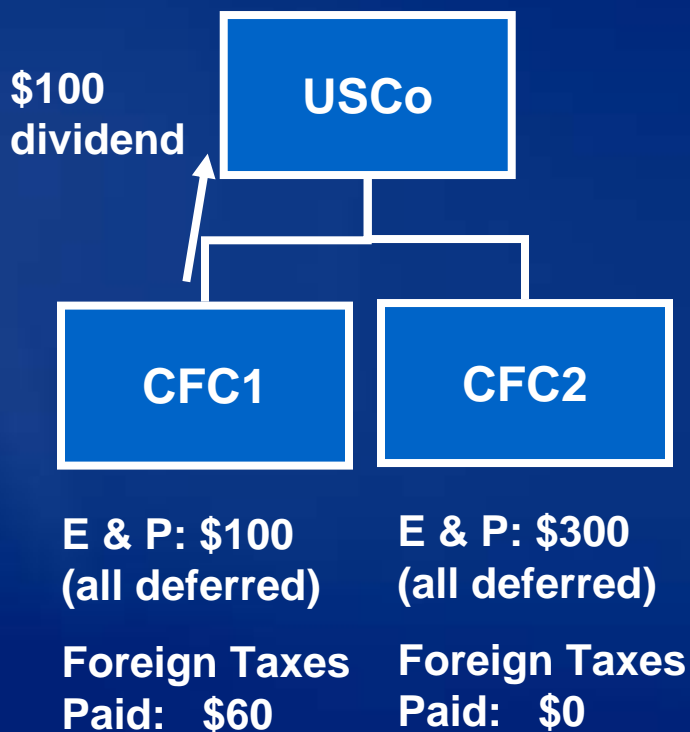
- Taxpayers (US groups) would have to aggregate foreign taxes and E & P of all §902-eligible (indirect FTC) foreign subsidiaries for purposes of calculating deemed-paid foreign tax credit.
 - Contrast with §976 of Rangel Bill, which would have treated all CFCs as one CFC
- Deemed-paid foreign tax credit would be based on amount of aggregated E & P that is repatriated in that year.
- Proposal would prevent separation of foreign tax and income (e.g., through use of hybrid entities) by adopting a “matching rule.”

FTC Changes (Sec. 976 of Rangel Bill)

$$(\text{Total Foreign Taxes}) \times \frac{(\text{Current FSI})}{(\text{Current FSI} + \text{Deferred FSI})} = \text{Allowable Foreign Taxes}$$

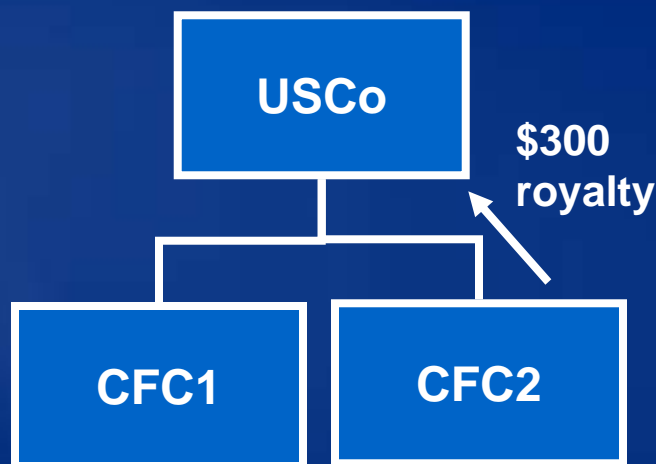
- ◆ **Total foreign taxes would include not just US group taxes but also all taxes paid by CFCs owned by US group.**
- ◆ **Proposal would treat all CFCs as one CFC.**
- ◆ **Ambiguity:**
 - Would new provisions apply before or in lieu of sections 901 (direct FTC) & 902 (indirect FTC)?
 - JC Report states that Administration proposal would modify section 902
 - Would limitation baskets (general and passive) continue to apply?
 - JC Report implies that proposal would include pre-effective date E&P and taxes in combined pools as well

FTC Example: §976 limitation



- ◆ **Current law: USCo's indirect credit would be the full \$60 from CFC1; \$160 total dividend and "gross up" (\$78) income; \$4 of excess credits above the \$56 (\$160 x 0.35) tax liability, which is usually available to credit against US tax on other FSI**
- ◆ **Under the Rangel Bill, USCo could credit 25% (\$100 current FSI/\$400 total FSI) of the \$60 in total foreign taxes, or \$15 in current year**
 - \$78 doesn't count for current FSI
 - Residual liability now of \$25.25 vs. excess credit of \$4
- ◆ **Remaining \$45 of foreign taxes "taken into account" pro-rata as the \$300 of CFC2's deferred earnings are repatriated**

FTC Example: §976 displacing §§ 902 and 960



E & P: \$100
(all deferred)

Foreign Taxes
Paid: \$60

E & P: \$0

Foreign Taxes
Paid: \$0

- ◆ CFC2 pays a \$300 royalty up to USCo, reducing its E & P to zero
- ◆ Current law: no FTC
- ◆ Under Rangel Bill, 75% (\$300 current FSI / \$400 total FSI) of the \$60 of CFC1 & CFC2's total foreign taxes, or \$45, is "taken into account"
- ◆ Does that mean "creditable" even though USCo has no taxes paid or deemed paid? Or are the \$45 of taxes potentially creditable subject to the application of sections 901 et seq.?

Check-the-Box Proposal: History

- ◆ **Check-the-box rules finalized in December 1996**
- ◆ **Concern from inception about their impact on US international tax rules (see preamble to T.D. 8697; JCS-6-97)**
- ◆ **Administrative proposals to correct perceived abuses**
 - Notices 98-11 and 98-35; Prop. Hybrid Branch rules; Prop. Extraordinary Transaction rules
 - More recently, Prop. amendment to Conduit Financing regs
- ◆ **Legislative remedies not as common (Section 894(c))**
- ◆ **Joint Committee 2005 proposal would require any separate foreign business entity that: (1) is organized under foreign law and (2) has a single member to be treated as a corporation**

Check-the-Box Proposal: Overview

- ◆ **Rhetorical emphasis on “disappearing” payments and entities.**
 - Similar concern as Notice 98-11 and Prop. Hybrid Branch Rules
- ◆ **Would prohibit disregarded entity election for foreign-owned eligible entities, unless owner is organized under laws of same country and is not disregarded.**
 - Not tied to CFC single-owners
 - JC Report suggests that a “subject to tax” requirement may replace or supplement the same country test
 - JC Report suggest that prohibition could extend to hybrid partnerships and reverse hybrids
- ◆ **Generally would not apply to a first-tier foreign eligible entity wholly-owned by a US person, except in cases of US tax avoidance**

Check-the-Box Proposal: Transition

- ◆ **Impacted disregarded entities would “spring to life” on effective date. As a result, “springing” debt and other now-regarded transactions could potentially give rise to income recognition events, such as**
 - Asset/share gain
 - Deemed dividends
 - Foreign currency gains and losses
 - Dual consolidated loss recapture
- ◆ **JC Report states that transition issues could lead to deferred effective date or other transition relief**

Check-the-Box Proposal: Post-Effective Date

- ◆ Use of same country subpart F exception possible
- ◆ Much less flexibility for cross-border M & A and certain restructuring transactions—may be necessary to legally liquidate, amalgamate, convert, etc., entities for purposes of, e.g., ensuring asset reorganization treatment
- ◆ More difficult to structure acquisitions of foreign corps as asset acquisitions—may need to satisfy §338 (Election to treat a stock acquisition as an asset acquisition, which must meet stringent requirements)

What concerns are we hearing from the Market?

◆ US CEOs:

- Changes to their cash tax
- ETR
- Ability to compete with foreign owned organizations

◆ Tax Directors:

- Complexity of evaluating the impact of the proposals on their tax provision model and data collection systems
- The evaluation of restructuring actions that should be contemplated/considered to address the potential changes

◆ Foreign Owned US Corporations:

- Foreign owned organizations which may have historical sandwich structures (US subsidiaries holding CFCs)
- Out-from-under planning in the US
- The possible elimination of the 80/20 company rules (i.e. qualifying foreign owned organizations should be considering repatriation of cash in the near future)

Company Considerations

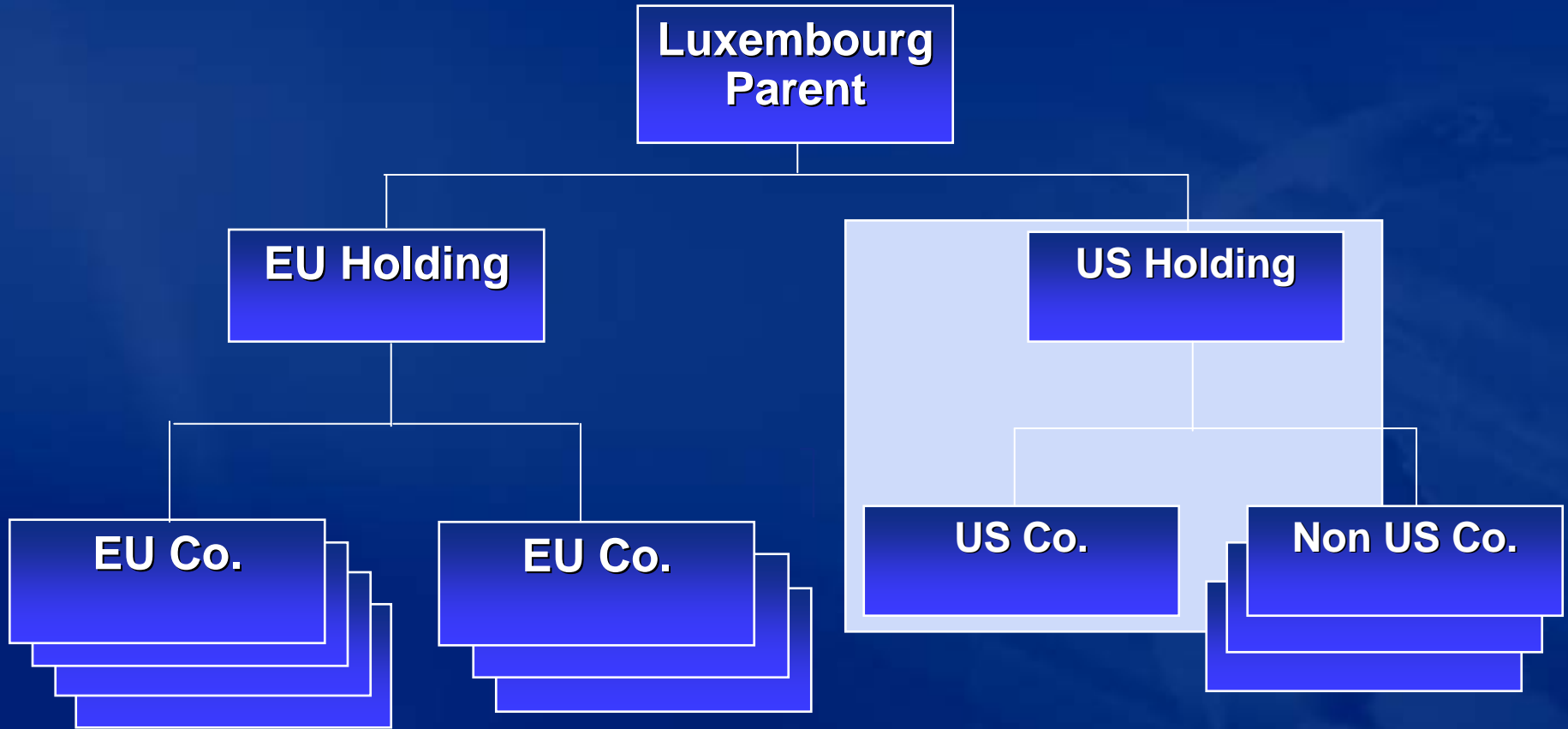
◆ Modeling the impact of the proposed tax reforms

- Estimation of the cash tax and financial statement ETR impact utilizing historical (or forecasted) financial information

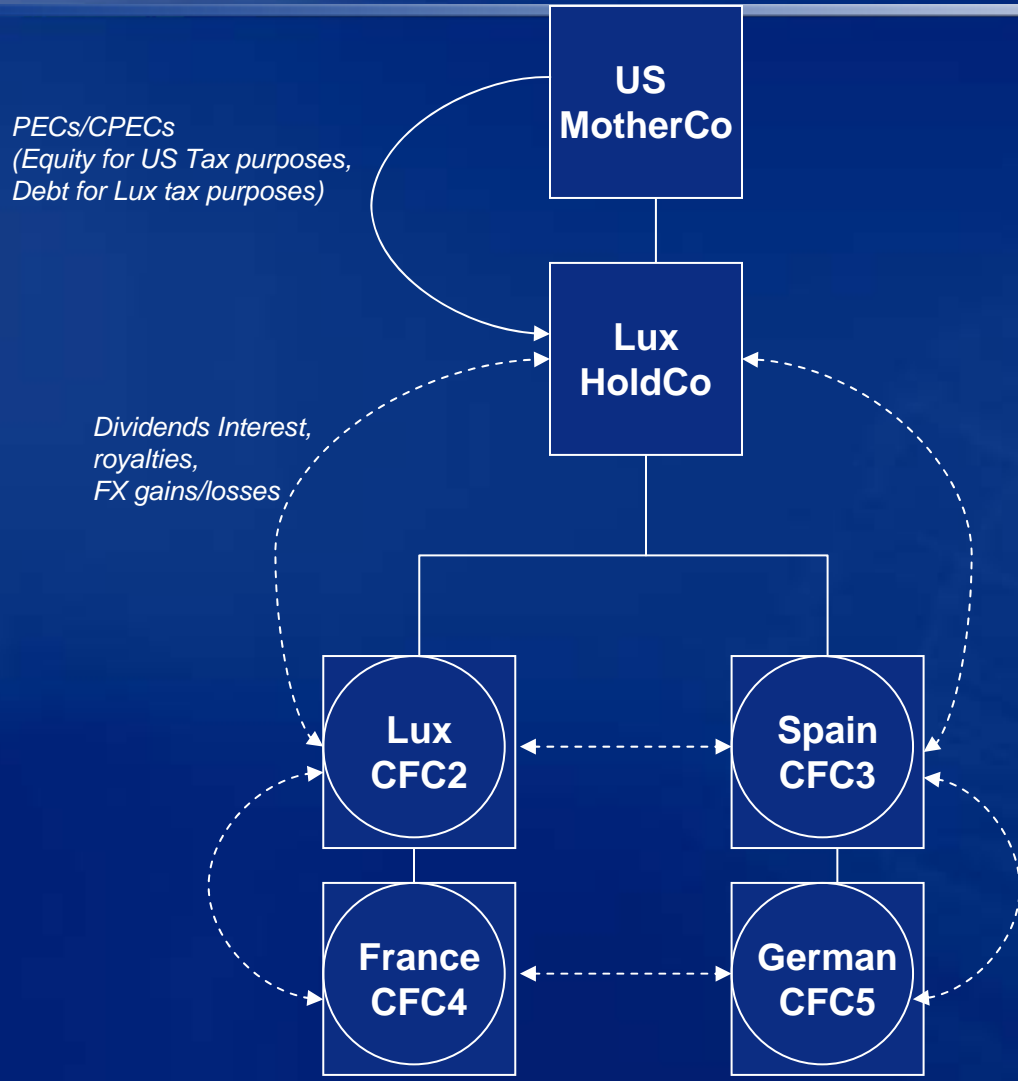
◆ Planning

- Re-evaluate the group ownership and operating structures
 - Joint ventures or branches vs. CFCs
 - Foreign owned entities should refocus on the cost/benefit of unwinding sandwich structures in the US (particularly in this economic environment)
- For CFCs, increase deferred active income and decrease or defer deductions until post-effective date
 - Assumes formulas based on current FSI (US shareholders should do the converse)
- Minimize FReDs and deferred FSI
 - Modify how US business is funded via, e.g., leasing or preferred equity
- Re-evaluate sourcing of foreign vs. domestic income

European Investment in the US - Post Acquisition Restructuring?



Example of Proposed CTB Reform on LuxHoldCo with Check-the-Box CFCs



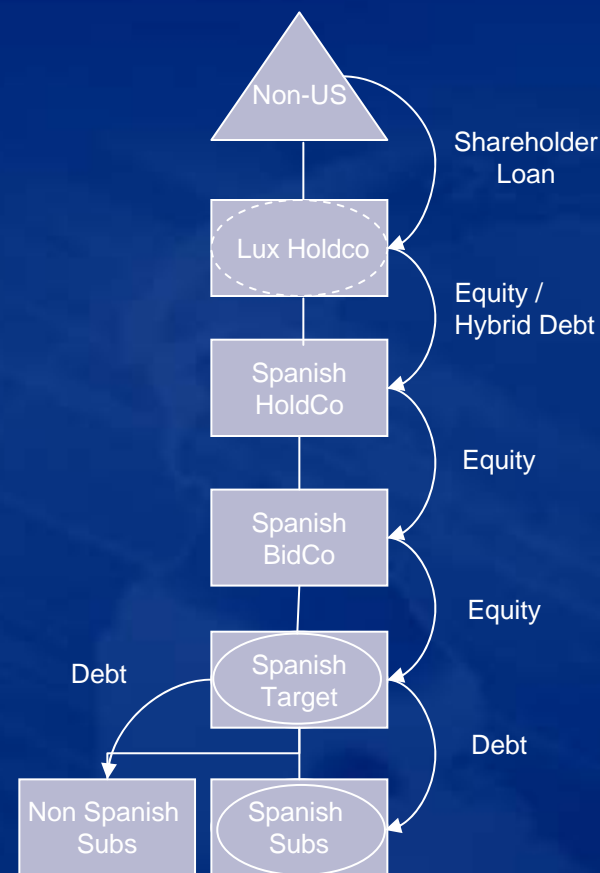
Example 1: Shareholder Loan

Facts:

- ◆ Non-US Fund holds Lux HoldCo financed with 15% equity and 85% shareholder loan

Certain US tax consequences:

- ◆ Under the current law, the shareholder loan from the Fund to Lux HoldCo should be disregarded. As a result, the Fund should not be required to accrue interest income and dry income should not arise, assuming that the Spanish HoldCo instruments qualify as equity for US tax purposes.
- ◆ Under the 2011 Proposals, Lux HoldCo may not be considered as a first tier disregarded entity; however, it is unclear how 2011 Proposals will apply to foreign companies owned by partnerships. As a result, it may be treated as a corporation for US tax purposes.
 - The conversion of Lux HoldCo into a corporation could be treated as a contribution of the shares of Spanish HoldCo to Lux HoldCo in exchange for shares and a note.
 - The shares of Spanish HoldCo deemed exchanged for the note should be treated as a §304 sale which could result in a potential deemed dividend from Spanish HoldCo, a reduction of basis, and possibly capital gain
 - The shares of Spanish HoldCo deemed exchanged for Lux HoldCo shares should be subject to §367(a). As a result, if there is gain inherent in the shares of Spanish HoldCo, 5% (or greater) U.S. investors must enter into five-year gain recognition agreements (“GRA”s) to avoid current U.S. tax on gain. Within a private equity context, GRAs are often not commercially viable.
 - Going forward, the Fund would be required to accrue interest income on an annual basis without respect to cash payments.
 - This could result in the US taxable investors being subject to US tax without receiving cash (i.e., dry income).



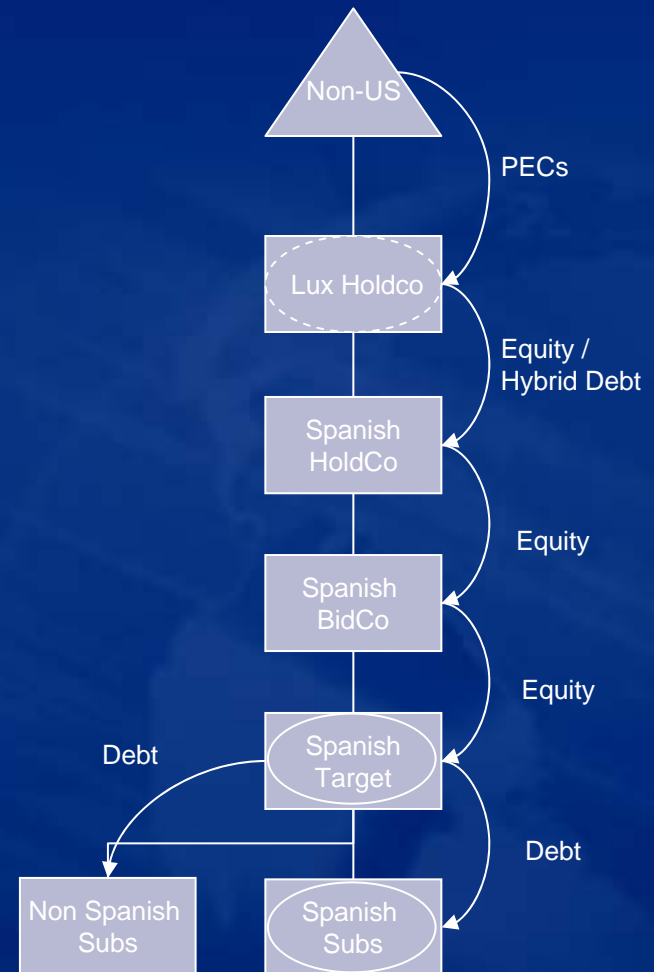
Example 2: Hybrid Instrument

Facts:

- ◆ Non-US Fund holds Lux HoldCo financed with 15% equity and 85% hybrid instrument (“PEC”)

Certain US tax consequences:

- ◆ Under the current US entity classification rules, the PEC instruments should be disregarded for US tax purposes. As a result, regardless of the terms of the PECs, the US taxable investors should not be required to accrue income assuming the Spanish Holdco instruments qualify as equity for US tax purposes.
- ◆ Under the 2011 Proposals, Lux HoldCo may not be considered a first-tier disregarded entity. As a result, Lux HoldCo may be treated as a corporation for US tax purposes.
 - The terms of the PEC instrument will need to be reviewed from a US tax perspective. The review should encompass:
 - US debt versus equity considerations;
 - If the PECs should be treated as non-qualified preferred stock (in which case, any gain inherent in the shares of Spanish HoldCo would be taxable); and
 - The need for the US taxable investors to accrue dividends under §305(c).
 - Depending on US tax characterisation of PEC instrument, see certain US tax consequences in Example 1

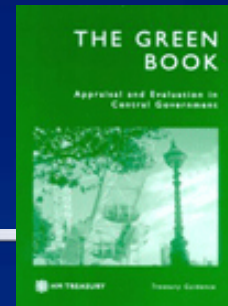


Check-the-Box Preparation and Planning

- ◆ Focus on transactions between regarded entities, *i.e.*, what other non-subpart F solutions are available?
- ◆ Transition rules/relief will be critical

Obama Administration QI Proposals

Overview



- ◆ Important changes proposed in Treasury Green Book with regard to:
 - Expanded 1099 reporting requirements
 - Expanded reporting by QIs
 - 30% withholding presumption on payments to non-US entities
 - Punitive treatment of NQIs
 - Money transfers by QIs
 - Reporting the establishment of offshore entities
- ◆ If proposals are enacted, US would move substantially from a relief at source jurisdiction to a reclaim system.
- ◆ This would come at a time that OECD proposals would move many reclaim countries towards the current QI model
- ◆ Changes would be effective from January 1st of the year following enactment



Obama Administration Proposals

Expanded 1099 reporting requirements

Reporting entities:

- Proposals would remove the distinction between US and non-US payors
- Could be expanded to all entities and branches under common ownership even if not acting as a QI



A sample image of a Form 1099-MISC document, showing the standard layout with various fields for reporting income and other payments.

Reportable amounts:

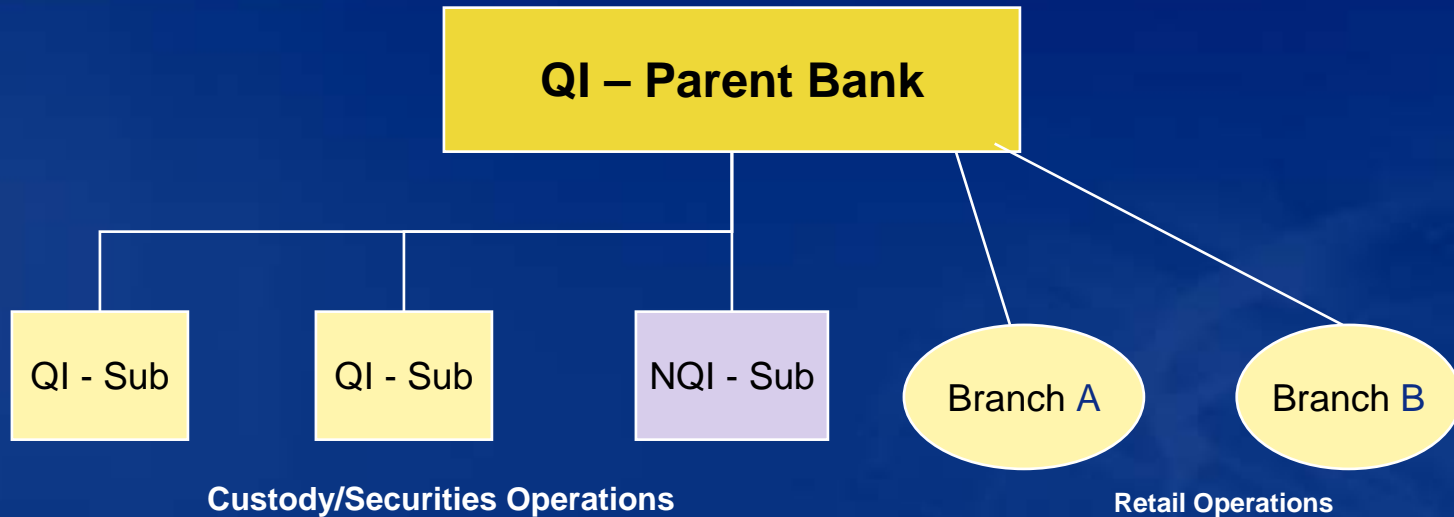
- Potential requirement for a QI to report all income and sales proceeds paid to US non-exempt recipients regardless of source
- Could impact the scope of QI audits to include accounts receiving payments reportable on Forms 1099 even where reportable amounts are not received



A sample image of a Form 1099-MISC document, showing the standard layout with various fields for reporting income and other payments.

Obama Administration Proposals

Expanded reporting by QIs



Potential changes:

For existing QI subs, Form 1099 reporting would be required for US AND Non-US securities

- Retail operations (Branches A & B) would file Forms 1099 for deposit interest, etc.
- Regulations could require NQI sub to become a QI
- Regulations could require QIs to obtain information of beneficial owners of foreign entity account holders and report any US beneficial owners

Obama Administration Proposals

30% WHT presumption on payments to non-US entities

QI information reporting expanded:

- Withholding agent paying interest or dividends to foreign entity need to apply 30%
- Certain exemptions:
 - pension funds,
 - publicly traded companies,
 - etc.
- Possible exemption for entities that enter into an agreement with the IRS to report all US non-exempt recipients to the IRS

Withholding agents
(including QIs)



30% WHT

Non-US entities

unless the entity provides
documentation of its
beneficial owners

Obama Administration Proposals

Proposed punitive treatment of NQIs

Payments to NQI:

- All income paid to an NQI would be subject to 30% withholding
- Sales proceeds would be subject to 20% withholding
- Would apply even where underlying beneficial owners are fully disclosed

Exceptions and reclaim system:

- Withholding on proceeds would not apply to NQIs in countries that have treaties that include satisfactory information exchange programs
- Would require NQIs to reclaim amounts overwithheld for direct account holders and the disclosure of US persons

Bank

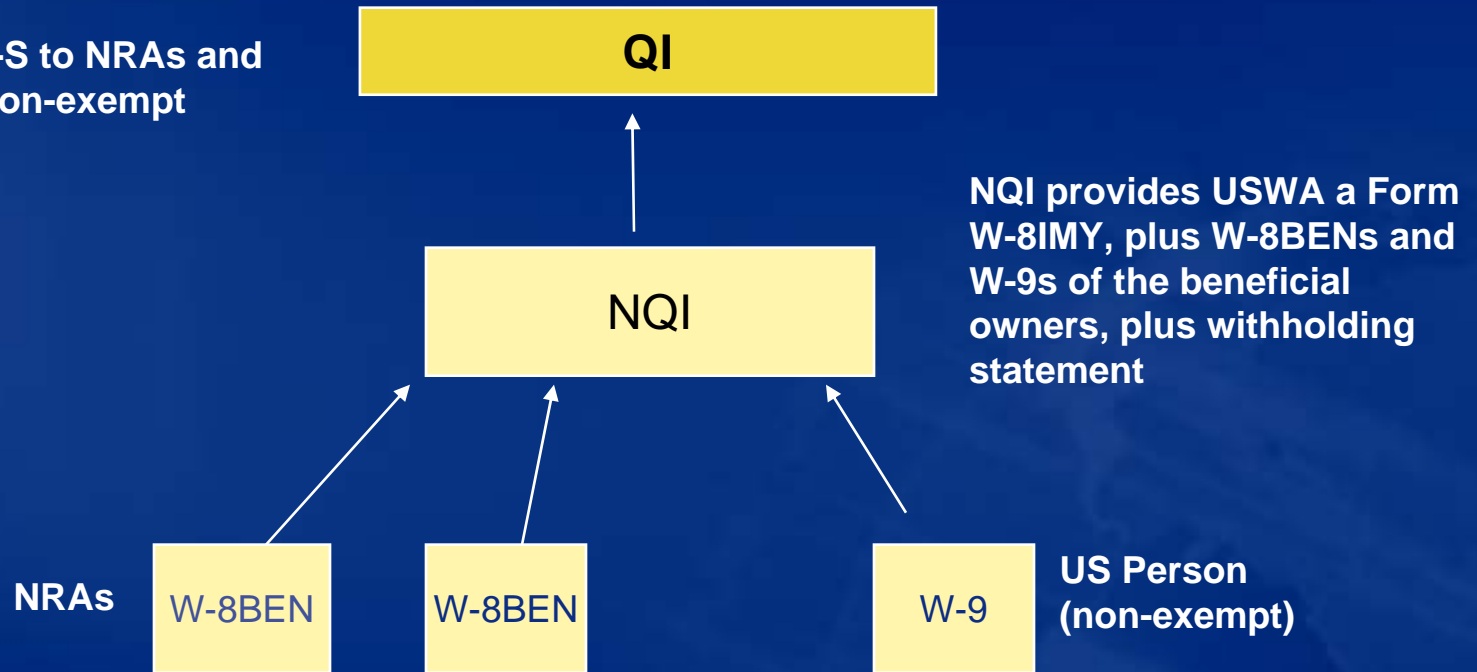


NQI

Obama Administration Proposals

Proposed penal treatment of NQIs

QI files 1042-S to NRAs and 1099 to US non-exempt recipient



- Current law: Reduced NRA withholding based on W-8BEN data
- Proposed changes:
 - 30% NRA withholding on FDAP to disclosed NRAs (even if BEN supports lower rate)
 - 20% on gross proceeds if NQI is in a country with unsatisfactory info exchange
- Unclear if proposed change would impact disclosed US persons

Obama Administration Proposals

Money transfer by QIs

QI information reporting expanded:

- **Transfers of money or property**
 - worth more than \$10,000
 - to or from a QI
 - on behalf of a US person
- would be subject to information reporting to the IRS.

- Although a similar proposal has been under discussion for US financial institutions, the Administration's proposal would apply to QIs as well.

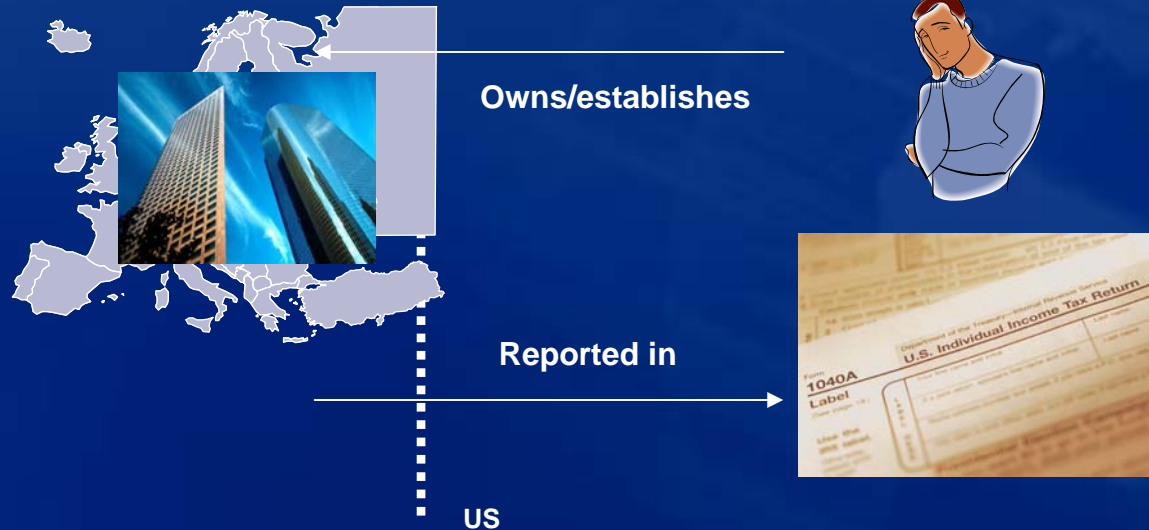


Obama Administration Proposals

Reporting the establishment of offshore entities

QI information reporting expanded:

- A QI (or any US person) would be required to report the formation or acquisition of a foreign entity for a US person.



Conclusion

- ◆ **Details and drafting still to come, but a few big-picture themes emerge to suggest now is the time to review the impact of these changes with respect to:**
 - Structures using CTB entities should be reviewed
 - US groups with substantial interest expense, SG&A, and/or utilizing cross-crediting against low-tax foreign source income may be particularly disadvantaged
 - There may never be a better time to restructure “sandwich” structures than now
 - Acceleration or deferral of certain income and expenses

Presenter's contact details

Birgit Hoefler

Partner

Luxembourg

KPMG Tax

+352 22 5151 5505

birgit.hoefler@kpmg.lu

Russ Crawford

Partner

US Tax Center in The Netherlands

KPMG Meijburg & Co.

+31 (0) 20 656 1222

crawford.russell@kpmg.nl

Mark French

Seconded Partner

US Tax Center in The UK

KPMG LLP

+44 (0) 207 694 1263

mark.french@kpmg.co.uk

Gérard Laures

Partner

Luxembourg

KPMG Tax

Tel: +352 22 5151 5549

gerard.laures@kpmg.lu