U.S. Multinational Corporation

Comprehensive Approach to Tax Planning

ESTABLISHING THE PLANNING FRAMEWORK

- Establishing the factual foundation for planning
- Reduce U.S. tax
- Reduce local country tax
- Utilize foreign tax credits
- Facilitate the movement of cash among foreign affiliates
- Provide for efficient repatriation of cash from foreign affiliates to the U.S. affiliated group

CONTINUOUS PLANNING APPROACH

	Reduce Global ETR on a Sustainable Basis			While Utilizing Cash Offshore or Repatriating Excess Cash			Within Global Business Strategy	Objectives
Building the Foundation	Reduce U.S. Local Country Taxes		Increase Foreign Tax Credit Utilization	Fully Utilize Offshore Cash		Repatriation of Offshore Cash	Sustainable Tax Positions	Goals
Tax Traits	In-Country Permanent Tax Savings (Foreign | U.S.)	Transfer Pricing	Increase FTC Limitation	Defer Earnings & Profits	Transfer Pricing	Annual	Establishing Controls and Documentation	Strategies
Capital Structure	Tax-Efficient Financing		Increase Creditable Taxes	Recirculate Offshore Cash		Structural	Tax and Financial Reporting	
Operating Models/ Value Drivers	Global Value Alignment		Accelerate Creditable Taxes	Efficient Use of Excess Cash Offshore		Situational	Tax Audit Defense	
Documentation	Tax Zone			Treasury Zone			Managing Risk	

Fact Pattern

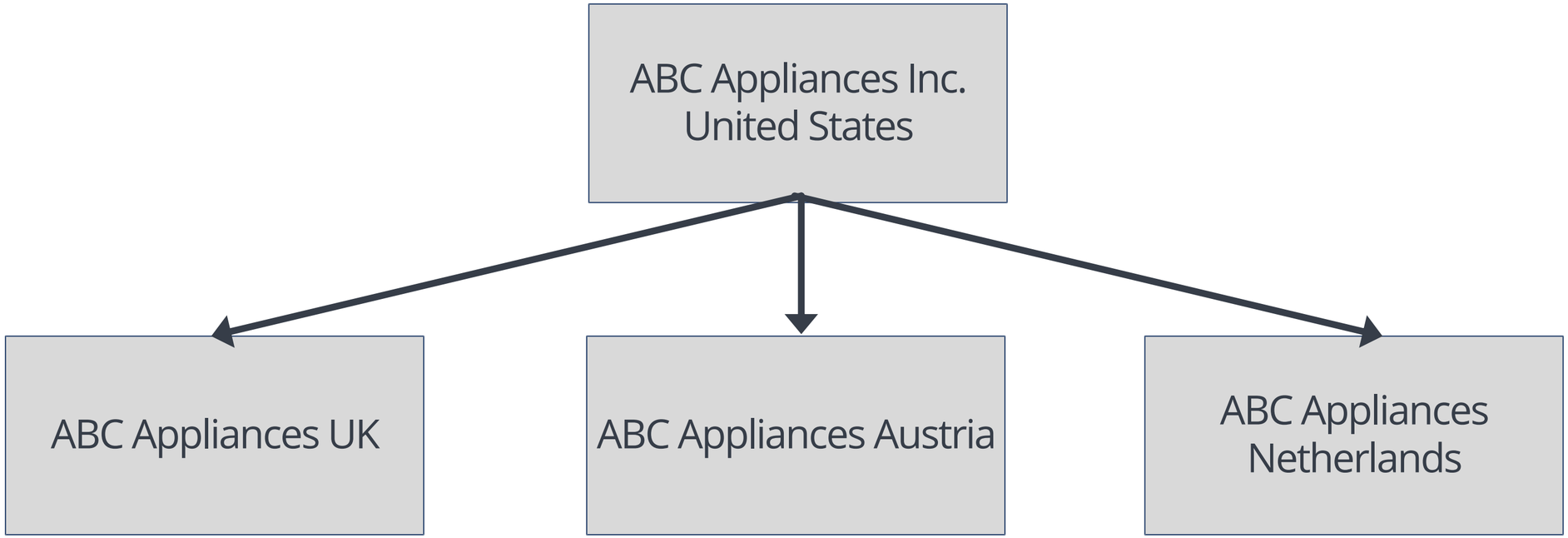
ABC Appliances Inc. is a Delaware corporation that manufactures and sells appliances in the United States and around the world. The demand for their products in Europe has significantly increased and ABC Appliances Inc. is expanding to certain locations in Europe.

ABC Appliances Inc. will have manufacturing facilities and sales offices in Austria, Netherlands, and United Kingdom. The cost of the manufacturing facility in each jurisdiction will be $100 million and the cost of the equipment at each location will be an additional $50 million.

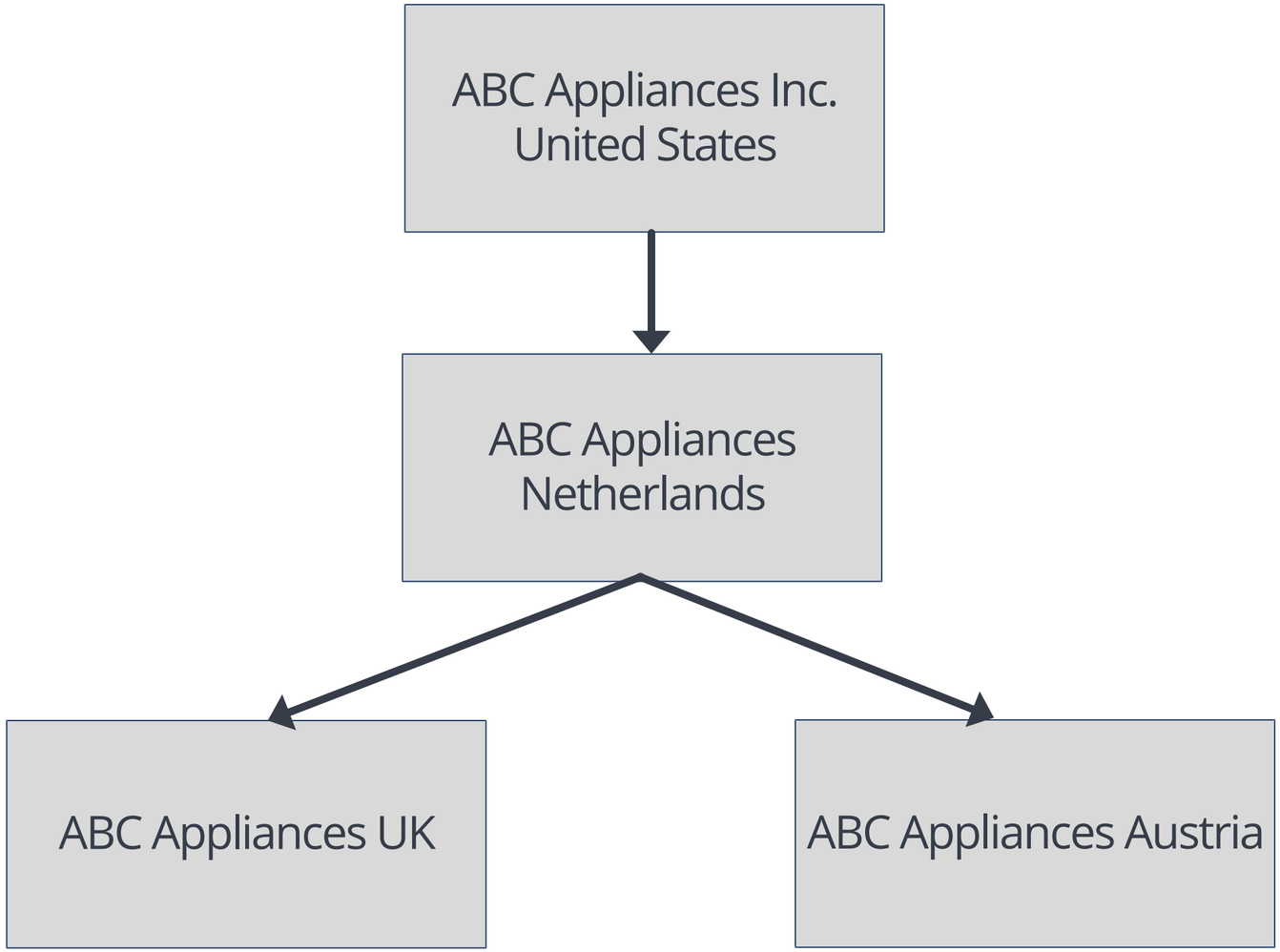
ABC Appliances Austria will both sell the appliances manufactured at its facility and make component parts that will be sold to ABC Appliances UK. ABC Appliances UK will use the component parts received from ABC Appliances Austria in the appliances manufactured at its facility. ABC Appliances UK will both sell appliances manufactured at its facility and make component parts that will be sold to ABC Appliances Netherlands. ABC Appliances Netherlands will use the component parts received from ABC Appliances UK in the appliances manufactured at its facility. ABC Appliances Netherlands will sell appliances manufactured at its facility to consumers.

As we work our way through the presentation, examples will b eprovided to illustrate the tax implications among ABC Appliances multinational group including formation and initial contributions, tax implications of operations, movement of cash and products between related companies, Treaty considerations, and repatriation of profits.

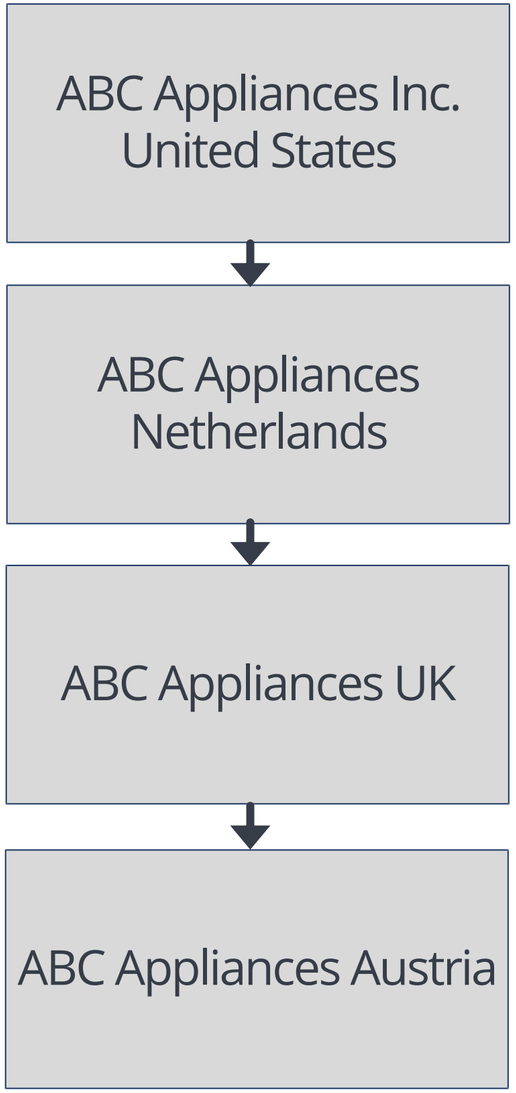
U.S. Parent Corporation



Europe Foreign Parent Brother-Sister Corporations



Europe Foreign Parent Subsidiary Chain



Entity Classification Rules for Offshore Companies

- Default entity classification rules are not the same for offshores entities
  - For example, a foreign limited liability company is taxed as a corporation by default

- Default classification rules for non-U.S. entities:
  - If all owners have limited liability the default classification is corporation
  - If any owner has unlimited liability the default classification is a disregarded entity if a single owner and partnership if there is more than one owner

- Check-the-box regulations to elect the tax treatment desired with the exception of *per se* corporations

- Hybrid entities and special tax treatment

U.S. Multinational Corporation

- Starting Point of U.S. federal income taxation of foreign corporations
  - U.S. federal corporate tax rules apply as they apply to domestic corporations unless modified
- Anti-deferral concerns create complex set of U.S. tax rules
- Transfers of property to foreign corporations could be a taxable event
- Controlled foreign corporations: subpart F income, GILTI, and Section 245A

Financing and Transfer of Assets to each European Subsidiary Corporation

ABC Appliances Inc. will need to provide financing in some form to fund the construction of each manufacturing plant, purchase the equipment, and initial funding of operations. The anticipated funding needed at each European subsidiary is anticipated to be $200 million. In addition, ABC Appliances Inc. will transfer ownership of certain intellectual property to each European subsidiary worth $25 million for which ABC Appliances Inc. has a $1 million tax basis in each intellectual property group being transferred.

Financing and Transfer of Assets to each European Subsidiary Corporation

Option 1: ABC Appliances Inc. can make an equity contribution to each subsidiary in the amount of $200 million and contribute the Intellectual Property to each European subsidiary.
Unlike the transfer of intellectual property to domestic corporations, the transfer of intellectual property to a foreign corporation will result in taxable gain. The transfer of the intellectual property to the three European subsidiaries will result in taxable gain of $72 million to ABC Appliances Inc.

Financing and Transfer of Assets to each European Subsidiary Corporation

Option 2: ABC Appliances Inc. can contribute $50 million and loan the other $150 million at 5% interest to each European subsidiary. ABC Appliances licenses the right to use the intellectual property to each European subsidiary at a cost of $2,500,000 million.

Assume the tax rate in the Netherlands is 19%, the United Kingdom is 25%, and Austria is 24%. Further assume, that each European subsidiary can receive a deduction against its taxable income for interest and royalty payments to ABC Appliances Inc.

In year one, each European subsidiary pays interest of $7,500,000 to ABC Appliances Inc. This creates taxable interest income of $22,500,000 to ABC Appliances Inc. taxed at a rate of 21%, resulting in tax of $4,725,000 ($1,575,000 attributable to each European subsidiary). ABC Appliances Netherlands will be able to deduct $7,500,000 against taxable income reducing taxes by $1,425,000. ABC Appliances UK will be able to deduct $7,500,000 against taxable income reducing taxes by $1,875,000. ABC Appliances Austria will be able to deduct $7,500,000 against taxable income reducing taxes by $1,800,000. In the aggregate, the European subsidiaries are able to reduce their taxes by $5,100,000.

Financing and Transfer of Assets to each European Subsidiary Corporation

Option 2 Continued: In year one, each European subsidiary pays royalties of $2,500,000 to ABC Appliances Inc. This creates taxable royalty income of $7,500,000 to ABC Appliances Inc. taxed at a rate of 21%, resulting in tax of $1,575,000 ($525,000 attributable to each European subsidiary). ABC Appliances Netherlands will be able to deduct $2,500,000 against taxable income reducing taxes by $475,000. ABC Appliances UK will be able to deduct $2,500,000 against taxable income reducing taxes by $625,000. ABC Appliances Austria will be able to deduct $2,500,000 against taxable income reducing taxes by $600,000. In the aggregate, the European subsidiaries are able to reduce their taxes by $1,700,000.

Financing and Transfer of Assets to each European Subsidiary Corporation

Option 3: ABC Appliances Inc, can make an equity contribution of $450 million to a separate finance subsidiary located in the Netherlands (Netherlands Finance Co.) and make an equity contribution of $50 million directly to each European subsidiary. ABC Appliances Inc. licenses the right to use the intellectual property to each European subsidiary at a cost of $2,500,000 million (other than Netherlands Finance Co.).

In year one, each European subsidiary pays interest of $7,500,000 to the Netherlands Finance Co. This creates taxable interest income of $22,500,000 to Netherlands Finance Co. taxed at a rate of 19%, resulting in tax of $4,275,000 ($1,425,000 attributable to each European subsidiary). ABC Appliances Netherlands will be able to deduct $7,500,000 against taxable income reducing taxes by $1,425,000. ABC Appliances UK will be able to deduct $7,500,000 against taxable income reducing taxes by $1,875,000. ABC Appliances Austria will be able to deduct $7,500,000 against taxable income reducing taxes by $1,800,000. In the aggregate, the European subsidiaries are able to reduce their taxes by $5,100,000.

The tax implications of the royalty income are the same as in option 2.

Controlled Foreign Corporations (CFC)

- A non-U.S. corporation is a CFC if more than 50% of either the total combined voting power of its stock or the total value of its stock is owned (or treated as owned) by United States shareholders on any day during the foreign corporation's taxable year

- A United States shareholder is a U.S. person that owns or is treated as owning 10% or more of the total voting power of the foreign corporation's voting stock, or 10% or more of the total value of all the foreign corporation's classes of stock

- CFC Special Tax Categories: (1) Subpart F Income; (2) GILTI Inclusions; and (3) Exempt Income under IRC Section 245A

Controlled Foreign Corporations (CFC) – Subpart F Income

- U.S. Shareholders of a CFC must include in gross income their pro rata share of the CFC's (i) subpart F income, and (ii) investment of earnings in U.S. property

- A CFC's subpart F income for its taxable year cannot exceed the CFC's current year earnings and profits

- Subpart F income includes the following income derived by a CFC:
    - Insurance income
    - Foreign base company income
    - The sum of any illegal bribes or kickbacks paid on behalf of the CFC to a government employee or official
    - Income from disfavored foreign countries

- Certain Exceptions from Subpart F Income:
    - Related party dividends, interest, rents, and royalties
    - Same country exception
    - High-Tax Exception
    - De Minimis Exception

Controlled Foreign Corporations (CFC) – GILTI

- A U.S. shareholder must include in its taxable income for a taxable year its global intangible low-taxed income (GILTI)

- A U.S. shareholder's GILTI for a taxable year is the amount by which its net CFC tested income exceeds its net deemed tangible income return (NDTIR) for the year

- The GILTI regime will typically result in the U.S. shareholders being subject to current U.S. taxation on a significant portion of the income of its CFCs that is not otherwise subject to U.S. tax as effectively connected income (ECI) or subpart F income

Controlled Foreign Corporations (CFC) – IRC Section 245A

- IRC Section 245A provides a corporate U.S. shareholder a deduction for the foreign-source portion of any dividend received from a specified 10% owned foreign corporation (SFC)

- A corporate U.S. shareholder is not allowed a credit or deduction for foreign income taxes paid or accrued (or treated as paid or accrued) with respect to dividends for which a Section 245A dividend received deduction (DRD) is allowed

Tax Implications of Operations

During year one, each European subsidiary had the following tax items:

Tax Item	Amount
Gross Receipts	$60,000,000
Subpart F Income (Income from passive investments)	$2,500,000
Costs of Good Sold	($15,000,000)
Interest Expense	($7,500,000)
Officer Compensation	($3,500,000)
Depreciation	($7,100,000)
Royalties and license fees	($2,500,000)
Taxes (other than income taxes)	($2,000,000)
Expenses related to subpart F income	($1,200,000)
Net Income or (Loss)	$23,700,000

Assuming the same tax rates as the prior example for each European subsidiary, the following is the operating results in each European country and the United States.

Tax Implications of Operations

ABC Appliances Netherlands: For year one, ABC Appliances Netherlands will have net income of $23,700,000 taxed at a rate of 19%, resulting in year one tax of $4,503,000. For U.S. tax purposes, the income and expenses will need to be separated between subpart F income and Global Intangible Low-Taxed Income (GILTI). In order to get to earnings and profits, the income taxes paid in the Netherlands need to be deducted from net income. Earnings and profits of ABC Appliances Netherlands is $19,197,000.

Assuming that the Netherlands tax rate is the same across income categories, the taxes paid would be prorated between subpart F income and other income in proportion to net income of each. The taxes allocated to subpart F income is $247,000 ($1.3M/23.7M x $4,503,000). The taxes allocated to other categories of income is $4,256,000 ($22.4M/23.7M x $4,503,000).

The subpart F income earnings and profits is $1,053,000 ($1.3M - $247,000). This will increase the ABC Appliances Netherlands subpart F PTEP account by $1,053,000.

For the GILTI tested income or loss, the starting point is remaining E&P of $22,400,000 less the net deemed tangible income return (NDTIR). The NDTIR equals $15 million ($150 million (Manufacturing plant and facilities) x 10%). The E&P that is related to GILTI is $7,400,000. The allocable taxes paid in the Netherlands on this amount is $1,406,000. The GILTI category earnings and profits is $5,994,000 (7.4M - $1,406,000). The GILTI tested income for this CFC is $5,994,000.

This leaves $15,000,000 of E&P that falls outside the subpart F and GILTI current year inclusion regimes and may constitute IRC §245A dividend received deduction if the amount is distributed to ABC Appliances Inc. The Netherlands tax paid allocable to this category is $2,850,000.

Tax Implications of Operations

ABC Appliances UK: For year one, ABC Appliances UK will have net income of $23,700,000 taxed at a rate of 25%, resulting in year one tax of $5,925,000. For U.S. tax purposes, the income and expenses will need to be separated between subpart F income and Global Intangible Low-Taxed Income (GILTI). In order to get to earnings and profits, the income taxes paid in the UK need to be deducted from net income. Earnings and profits of ABC Appliances UK is $17,775,000.

Assuming that the UK tax rate is the same across income categories, the taxes paid would be prorated between subpart F income and other income in proportion to net income of each. The taxes allocated to subpart F income is $325,000 ($1.3M/23.7M x $5,925,000). The taxes allocated to other categories of income is $5,600,000 ($22.4M/23.7M x $5,925,000).

The subpart F income earnings and profits is $975,000 ($1.3M - $325,000). This will increase the ABC Appliances UK subpart F PTEP account by $975,000.

For the GILTI tested income or loss, the starting point is remaining E&P of $22,400,000 less the NDTIR. The NDTIR equals $15 million ($150 million (Manufacturing plant and facilities) x 10%). The E&P that is related to GILTI is $7,400,000. The allocable taxes paid in the UK on this amount is $1,850,000. The GILTI category earnings and profits is $5,550,000 (7.4M - $1,850,000). The GILTI tested income for this CFC is $5,550,000.

This leaves $15,000,000 of E&P that falls outside the subpart F and GILTI current year inclusion regimes and may constitute IRC §245A dividend received deduction if the amount is distributed to ABC Appliances Inc. The UK tax paid allocable to this category is $3,750,000.

Tax Implications of Operations

ABC Appliances Austria: For year one, ABC Appliances Austria will have net income of $23,700,000 taxed at a rate of 24%, resulting in year one tax of $5,688,000. For U.S. tax purposes, the income and expenses will need to be separated between subpart F income and Global Intangible Low-Taxed Income (GILTI). In order to get to earnings and profits, the income taxes paid in Austria need to be deducted from net income. Earnings and profits of ABC Appliances Austria is $18,012,000.

Assuming that the Austria tax rate is the same across income categories, the taxes paid would be prorated between subpart F income and other income in proportion to net income of each. The taxes allocated to subpart F income is $312,000 ($1.3M/23.7M x $5,688,000). The taxes allocated to other categories of income is $5,376,000 ($22.4M/23.7M x $5,688,000).

The subpart F income earnings and profits is $988,000 ($1.3M - $312,000). This will increase the ABC Appliances Austria subpart F PTEP account by $988,000.

For the GILTI tested income or loss, the starting point is remaining E&P of $22,400,000 less the NDTIR. The NDTIR equals $15 million ($150 million (Manufacturing plant and facilities) x 10%). The E&P that is related to GILTI is $7,400,000. The allocable taxes paid in Austria on this amount is $1,776,000. The GILTI category earnings and profits is $5,624,000 (7.4M - $1,776,000). The GILTI tested income for this CFC is $5,624,000.

This leaves $15,000,000 of E&P that falls outside the subpart F and GILTI current year inclusion regimes and may constitute IRC §245A dividend received deduction if the amount is distributed to ABC Appliances Inc. The Austria tax paid allocable to this category is $3,600,000.

Tax-Efficient Utilization of Foreign Tax Credits

- Foreign tax credit planning must take into account the following issues:
  - Is the foreign tax a creditable foreign income tax
  - Does the corporation have sufficient foreign tax credit capacity (sufficient foreign source taxable income) determined under 904 to allow the taxpayer claim the foreign tax credit
  - Is there sufficient cash or debt capacity to allow for payment of a direct or indirect dividend by the correct affiliate allowing the U.S. shareholder to claim credits to the earnings of a lower-tier subsidiary

- For tax years starting after December 31, 2017, the foreign tax credit limitation calculation applies to four separate categories of income:
  - GILTI
  - Foreign branch income
  - Passive category income
  - General category income

- Allocation of deductions to categories of income

U.S. Tax Results of Operations for Year One

The tax implications to ABC Appliances Inc. resulting from the operations of the European subsidiaries requires the determination of U.S. federal corporate income tax (U.S. CIT) attributable to each category of income and the applicable foreign tax credits to each category.

SUBPART F INCOME: The U.S. CIT on the subpart F income of the European subsidiaries is $819,000 (($3,016,000 + $884,000 (Gross-Up Amount)) x 21%). This income is in the passive category. The foreign taxes paid on the subpart F income of the European subsidiaries is $884,000. The foreign tax credit will eliminate the U.S. CIT on the subpart F income from the European subsidiaries. There is $65,000 of foreign taxes paid over the amount credited against the U.S. CIT.

The corporate income tax rate in the country of each European subsidiary would qualify for the High-Tax Exception and, therefore, be exempt from subpart F income. If the exemption is claimed, the income would move to the GILTI category where the High-Tax Exception could also be claimed. Should the High-Tax Exception be claimed? This will depend on whether the taxes in excess of the U.S. CIT can be credited against other passive category income taxes.

For example, assume that ABC Appliances Inc. has passive category income of $300,000 from a wholly owned corporation located in Tax Haven ("Tax Havenco"), a jurisdiction which does not have a corporate income tax. The U.S. CIT applicable to this income is $63,000. If the High-Tax Exception were claimed for the European subpart F income, then ABC Appliances Inc. would owe U.S. CIT of $63,000. However, if the High-Tax Exception is not claimed for the European subpart F income, then there would be enough foreign tax credits remaining from the foreign income taxes paid in the jurisdictions of the European subsidiaries to reduce the U.S. CIT to $0 on the subpart F income from Tax Havenco.

U.S. Tax Results of Operations for Year One

GILTI: The U.S. CIT on the GILTI Tested Income of the European subsidiaries is $2,331,000 (($17,168,000 + $5,032,000 (Gross-Up Amount)) x 21% = $4,662,000 – $2,331,000 (50% reduction in tax on GILTI)). This income is in the GILTI category. The foreign taxes paid on the GILTI Tested Income of the European subsidiaries is $5,032,000. Only 80% of the taxes paid on GILTI are creditable, or $4,025,600. The foreign tax credit will eliminate the U.S. CIT on the GILTI Tested Income from the European subsidiaries. There are $1,694,600 of foreign taxes paid over the amount credited against the U.S. CIT.

The corporate income tax rate in the country of each European subsidiary would qualify for the High-Tax Exception and therefore be exempt from GILTI. If the exemption is claimed, the income would move out of the GILTI category. Should the High-Tax Exception be claimed? This will depend on whether the taxes in excess of the U.S. CIT can be credited against other GILTI Tested Income.

For example, assume that ABC Appliances Inc. has GILTI Tested Income of $15,000,000 from a wholly owned corporation located in Tax Haven ("Tax Havenco"), a jurisdiction which does not have a corporate income tax. The U.S. CIT applicable to this income is $1,575,000. If the High-Tax Exception were claimed for the European GILTI, then ABC Appliances Inc. would owe U.S. CIT of $1,575,000. However, if the High-Tax Exception is not claimed for the European GILTI, then there would be enough foreign tax credits remaining from the foreign income taxes paid in jurisdictions of the European subsidiaries to reduce the U.S. CIT to $0 on the GILTI Tested Income from Tax Havenco.

U.S. Tax Results of Operations for Year One

Remaining E&P and Taxes on Remaining E&P: There are no taxes on the remaining E&P from the European subsidiaries of $34,800,000. The taxes applicable to the Section 245A dividend received deduction are not creditable for foreign tax credit purposes.

Repatriation of Profits

Current Year: 245A Dividend up to $34,800,000

- Return of capital distribution in excess of $34,800,000
- Interest: $22,500,000
- Royalties: $7,500,000
- Stock Based Incentive Program with ABC Appliances Inc. Stock for CFC employees: CFC reimburses price of stock to ABC Appliance Inc.
- Transfer Pricing Goods and Services

Following Year:

- Distribution of subpart F PTEP amount of $3,016,000 and GILTI PTEP amount of $17,168,000

Treasury Functions

- **Treasury Objectives:** The treasury function will not always appreciate the tax impact of moving cash from one affiliate to another. In an effort to maximize the value of working capital, the treasury will often seek to redeploy capital to the location where it is needed most in the enterprise. Keeping this flexibility in mind is important to achieving the balance between the treasury needs and tax efficiency

- **Subpart F Income:** The structure should facilitate the movement of capital but minimize the exposure to subpart F income resulting from payments between CFCs

- **Foreign Tax Credits:** Structuring cash flow between affiliates must take into account the impact of the transaction or structure on the ability to claim foreign tax credits

- **Foreign Currency:** Many transactions involve the movement of capital between affiliates or branches using different functional currencies; the possible recognition of currency gain or loss on these transactions must be addressed

ABOUT CHRISTOPHER M. KLUG

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