International Tax Conference (IFA Germany)

Berlin, 7 July 2017, 4pm to 5:30pm
Panel on
Updates and analysis on international tax developments

Panellists:
Prof. Dr. Pascal Hinny, Lenz & Staehelin (Zurich- Switzerland)
Karl Lee, KPMG LLP (London- Great Britain)
Prof. Dr. Stephan Rasch, PricewaterhouseCoopers (Munich- Germany)

Chair:
Wilhelm Haarmann, Linklaters, (Frankfurt am Main- Germany)

Agenda

I. Practical Implementation of BEPS requirements in the companies
II. The implementation of the Multilateral Convention in various countries
III. Taxation of Permanent Establishments, Definition, Profit Attribution
IV. Swiss Changes of Corporate Taxation with particular focus on Special Tax Regimes
V. Cross Border IP taxation (Patent Boxes etc.)
VI. American Taxation of Inbound Financing
VII. Exchange of Tax Rulings
VIII. Differentiation between legality and legitimacy in tax law

I. Practical Implementation of BEPS requirements in the companies

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a) The German experience

b) The Swiss experience

c) The US experience

I. Practical Implementation of BEPS requirements in the companies

b) The Swiss experience

- Adaptation to changing legal framework
- Exchange of information (termination / adaptation of tax rulings);
- Corporate tax reform: termination of special tax regimes & cope with replacement measures
- Country by country reporting
- Review transfer pricing: Risk & function analysis
- Consolidation of activities
- Documentation of assumption of functions and risks and of transfer pricing

II. The implementation of the Multilateral Convention in various countries

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a) The intended OECD method

b) The German way

c) The Swiss way

d) Will there be a U.S. way?

II. The implementation of the Multilateral Convention in various countries

c) The Swiss way (1/2)

- Switzerland signed the MLI on June 7, 2017
- Switzerland commits itself largely to the minimum standard, i.e.
  - BEPS Action 6: Prevention of treaty abuse: **Principle purpose test (PPT)**; **Adaptation of preamble** (Art. 6 MLI) and standard anti-abuse clause (Art. 7(1) MLI; 7(3-4)?)
    - Interaction with existing BO-test according to Swiss Supreme Court practice tbd
  - BEPS Action 14: Improving dispute resolution:
    - **Mutual agreement procedure (MAP)**: Art. 16 MLI (no corresponding adjustment)
    - **Mandatory and binding arbitration** (opt-in): Art. 18 – 26 MLI
  - Reservation Art. 35(7) MLI
  - Opt-out for all other provisions

II. The implementation of the Multilateral Convention in various countries

c) The Swiss way (2/2)

Initial Application

- Initially, treaties with Argentina, Chile, India, Iceland, Italy, Liechtenstein, Lithuania, Luxembourg, Austria, Poland, Portugal, South Africa, the Czech Republic and Turkey will be amended (14 treaties)

Modus of Implementation

- Change of existing treaties (vs. coexistence), i.e. formal transformation required (ggf. "Änderungsprotokoll")

Legal Implementation Procedure

- Federal Council: Submit BEPS Convention for public consultation end of 2017
- Parliamentary approval process likely in 2018
- Entry into force not expected before January 1, 2019

III. Taxation of Permanent Establishments, Definition, Profit Attribution

Presentation by Prof. Dr. Stephan Rasch, PwC

Presentation will be linked here in it‘s original format

1 - Identification of a PE - Recap

Recent OECD Publications on PEs

Overview

PE Attribution

OECD: Report on the Attribution of Profits to Permanent Establishments, 2010

- General Considerations
- Special Considerations for:
  - Bank PEs
  - Global Trading PEs
  - Insurance PEs

PE Identification

BEPS Action 7: Preventing the Artificial Avoidance of PE Status, 2015

- Commissionaire Arrangements
- Specific Activity Exemptions
- Splitting-up of Contracts
- Dependent Agents

PE Attribution

BEPS Action 7: Additional Guidance on the Attribution of Profits to PEs, 2016 and 2017

- **Dependent Agents (4 examples 2016, 3 examples 2017)**
- Warehouses (1 example 2016)
- Fragmentation of activities (1 example 2017)
- Coordinating the Application of Art. 7 and Art. 9 OECD-MC

BEPS Action 7 report (5 October 2015)

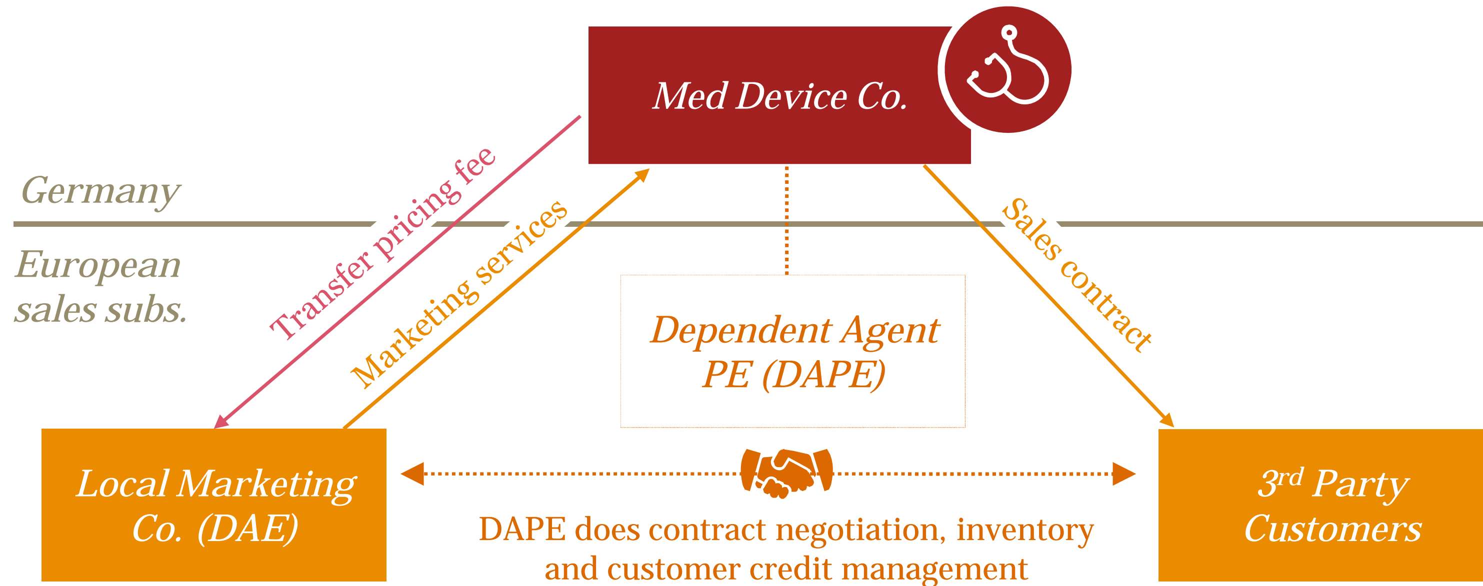
Preventing the artificial avoidance of PE status – proposed changes to the OECD'S MTC Art.5

What's new / what has changed?

Dependent Agent PE (DAPE)	• Principal role leading to the conclusion of contracts • Routinely concluded w/o material modification • Examples: Commissionaires, Sales Agents
Preparatory / auxiliary activities	• Activities actually have to be preparatory / auxiliary (no general assumption anymore → warehouses, purchasing activities, etc. can create PE)
Anti-fragmentation / splitting contracts	• Prevent fragmenting into several small operations or splitting-up of contracts • Collective consideration of group's foreign activities

A Multilateral instrument was signed by 68 jurisdictions on 7 June 2017 to begin the process of enacting the selected new Art.5 measures. A process of ratification will follow in each jurisdiction.

Example 1 - Dependent Agent PE

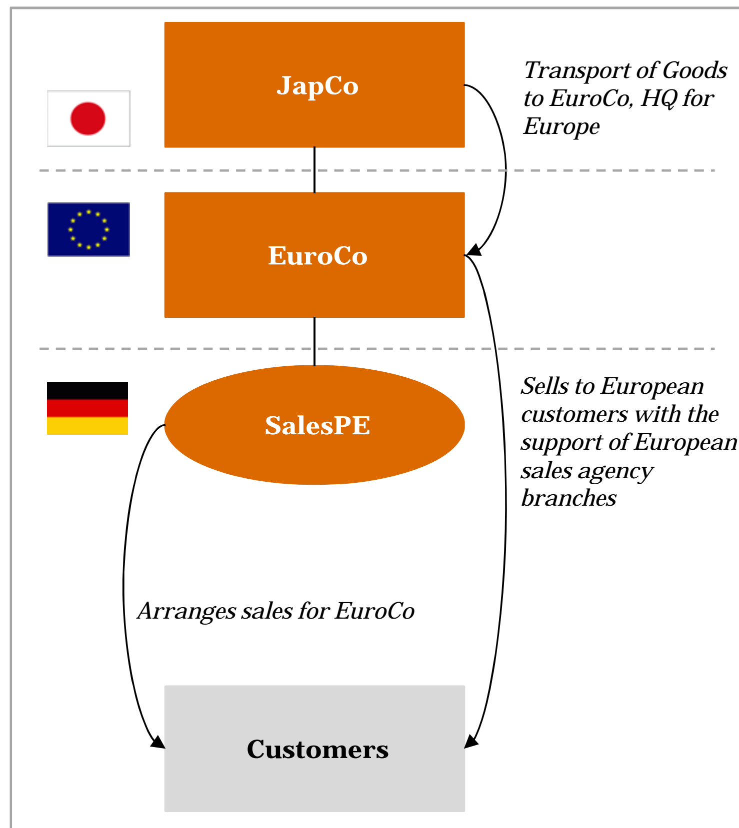


Question	Pre-BEPS	Post-BEPS
Existence of PE	No	Yes
PE profit attribution	No	Yes, apply AOA (but maybe no additional profit attributable)

2 - Attribution of profits to a PE – the AOA

Example 2 - PE Profit Attribution

European sales PEs – sales agency services



Case Facts

- Central distribution hub in (EuroCo) with German sales agency offices (SalesPE).
- The SalesPE(s) markets, negotiates and sells the goods to customers in their respective territory within authorized guidelines from EuroCo.
- SalesPE doesn't perform Significant People Functions with respect to its local marketing and selling activities. Strategic decisions are usually taken at EuroCo.

Legal Analysis

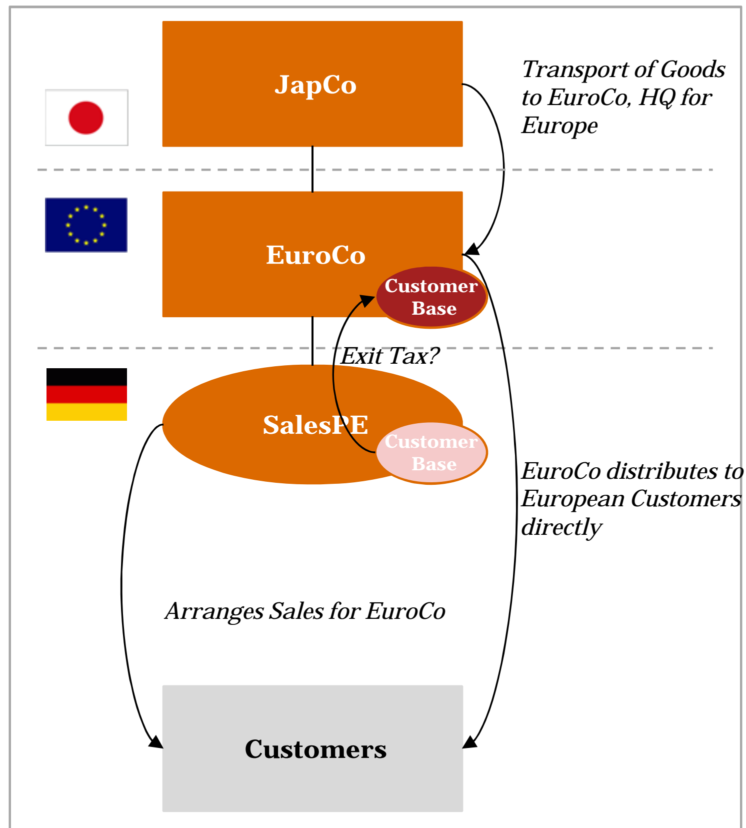
- Tangible assets – SalesPE would be attributed locally used tangibles assets i.e. warehouse and office equipment.
- Intangible assets – non-routine valuable marketing intangibles are economically owned by Euroco.
- Risks – SPFs in relation to key financial, market and product liability risks undertaken by EuroCo
- Capital – given the routine nature of the SalesPE, the level of capital and interest bearing liabilities to cover the assets and risks is also likely to be low.
- As a result, the fictional dealings between EuroCo and the SalesPE include:
  - the SalesPE's routine sales agency activities, and
  - Management services from EuroCo to SalesCo i.e. IT/accounting
- The above dealings can be priced based on transfer pricing methods e.g. a cost plus method

Documentation / Auxiliary Calculation

- As the SalesPE is acting as a sales agent on behalf of EuroCo in the local market, and therefore is routine in nature, the Branch book values may be an appropriate starting point – consider if the book values match the arm's length value for all items attributed to the branch.

Example 3 - PE Profit Attribution

Sales PE Stripped down to Sales Support Service



Case Facts

- Germany SalesPE
- Over time 2 of the 5 employees of the SalesPE have developed a valuable local customer base and performed the significant people functions in relation to the local customer base.
- At the end of this fiscal year these employees are due to transfer to EuroCo permanently and will continue managing the Germany local customer base.

PE Profit Attribution, Documentation and Auxiliary Calculation

- Up until the end of the year, the ownership of the valuable local customer base may result in the attribution of risks and assets (in particular the valuable customer base) above what is attributed per the branch accounts.
- Note that all items should be attributed at the correct transfer pricing (arm's length) value, including the customer base.

Potential Exit Tax

- Exit Tax risks need to be considered due to:
  - the change of functions in Germany; and
  - the relocation of (valuable) intangibles such as the customer base.

3 - Germany specifics

Profit Attribution – Germany

Comparison of "old" and "new" legal framework

Prior Regulations (Relevant Business Activity Approach)	New Regulations (Authorized OECD Approach)
PE qualifies as inseparable part of the company → Split of profits and expenses between head office and PE	PE generally deemed as separate and independent entity for tax purposes → Application of the arm's length principle to „dealings" between head office and PE (not applicable for loans)
Assets to be attributed to head office <u>or</u> a certain PE (no pro-rata allocation)	(Intangible) assets may be attributed to head office and PE under certain requirements (pro-rata allocation)
Shareholdings and financial resources are generally attributed to head office (exemption: functional link to the business activities of the PE)	Shareholdings and financial resources may be attributed to head office or PE
Interest expense generally attributed based on functionality aspects (exemption: re-qualification of equity into debt if PE is under-capitalized)	Interest expense mainly determined by fixed calculation scheme (debt = sum of all assets attributed to PE <u>minus</u> equity attributed to PE)
Transfer of function regulations not applied between head office and PE (i.e. no package valuation approach)	Transfer of function regulation potentially applicable for transfers between head office and PE
General documentation requirements as for cross-border transactions between related companies according to Section 90 General Tax Code	Additional documentation requirements besides Section 90 General Tax Code (e.g. preparation of an „auxiliary calculation" for the PE per fiscal year)

Profit Attribution – Germany

Summary of specific requirements/differences

Item	German New Regulations	AOA Requirement (OECD)
Approaches to the allocation of "free capital"	• **Inbound PEs:** Capital allocation method • **Outbound PEs:** Minimum capital method Unless the taxpayer can demonstrate that the different treatments are not in accordance with the arm's length principle	**No distinction between inbound and outbound PEs**, approaches allowed include (para 115 onwards, 2014 OECD PE Report): • Capital allocation method; • Economic allocation method; • Thin Capitalisation method; • Safe Harbour method (quasi thin capitalisation/regulatory min capital approach); or • Other methods (i.e. for the insurance sector)
Specific provisions for attribution of items to a PE	1. Attribution of People Functions (including SPFs/KERTS) 2. Attribution of Tangible assets 3. Attribution of Intangible assets 4. Attribution of Shareholdings, financial assets and similar assets 5. Attribution of Other assets 6. Attribution of Business transactions 7. Attribution of Hedging transactions 8. Attribution of Opportunities and risks 9. Determination of Equity (i.e. Capital including free capital) of PE 10. Attribution of other liabilities 11. Attribution of Financing Expenses	1. Functional and factual analysis (i.e. attribution of People Functions including SPFs/KERTS 2. Attribution of risks 3. Attribution of assets (tangible and intangible) 4. Attribution of rights and obligations 5. Attribution of capital (including free capital) 6. Recognition of "Dealings"
Banking, global trading and Insurance	KERT functions of risk management and trading/underwriting are at the **initial investment/underwriting decision**	KERT functions of risk management and trading/underwriting may be **at two points of time** - at the initial investment/underwriting time and at the future time when the decision to transfer the risk is performed.
Construction PEs	Specific regulations on the application of the AOA for construction PEs, including the following assumptions unless otherwise proven: • Tangible assets are provided free of charge to the construction PE; • The Head Office owns all the significant intangible assets; • The PE provides one service ("Dealing") to the Head Office as part of the construction contract; and • The construction PE is assumed to be a routine cost plus entity unless appropriate support can be provided for an alternative characterisation.	**No Specific guidelines for Construction PEs**. As Such PEs are to be treated under the general PE attribution considerations in Section 1 of the OECD PE Report.
Documentation	German PE documentation also requires the inclusion of a **"preparatory and supporting calculation"** being a P&L and Balance Sheet for the PE(s), with additional narrative explaining the allocation method for each item.	Per section D-4 OECD PE Report, PE documentation requirements **cross reference Transfer Pricing documentation requirements** as set out in Chapter V of the OECD's Transfer Pricing Guidelines for Multinational Enterprises.

IV. Swiss Changes of Corporate Taxation with particular focus on Special Tax Regimes

IV. Swiss Changes of Corporate Taxation with particular focus on Special Tax Regimes

Swiss corporate tax reform (1/2)

Status Quo: Taxation of special tax regimes

- Mixed Companies: Non-Swiss source income CIT 8.5-12%
- Holding Companies: Participation income virtually tax free; non-participation income CIT 7.8%
- Principal Companies: Non-Swiss income CIT 4.5 - 7.5%
- Finance Branches: Interest income CIT 1-1.5%

Corporate Tax Reform III (rejected by Swiss voters in February 2017):
- Abolishment of above regimes
- Replacement Measures
  - Patentbox
  - Notional interest deduction
  - R&D expense super deduction
  - Transitional measures
  - Maximum deduction of all above measures 80%
  - Reduced ordinary tax rates (overall average 15/16%, lowest 12%)

IV. Swiss Changes of Corporate Taxation with particular focus on Special Tax Regimes

Swiss corporate tax reform (2/2)

Revised government proposal (status June 2017)

- Abolishment of above regimes 2020 / 2021
- Replacement Measures
    - Patent box (narrower)
    - R&D expense super deduction (narrower)
    - Transitional measures
    - Maximum deduction of all above measures 70%
    - Reduced ordinary tax rates (overall average 15-16%, lowest 12%)

Proposed timing

- Hearings September – December 2017
- Government proposal for parliamentary discussions: March/April 2018
- Parliamentary discussions 2018
- Effective 2019 at the earliest with some transitional measures

IV. Swiss Changes of Corporate Taxation with particular focus on Special Tax Regimes

Swiss corporate tax reform: Patentbox (1/3)

Patentbox

› **In a nutshell**
  - Separate Taxation: Profit from patented and similar rights
  - Recapture of prior R&D expenses upon entry in the box: High tax payments up-front!!

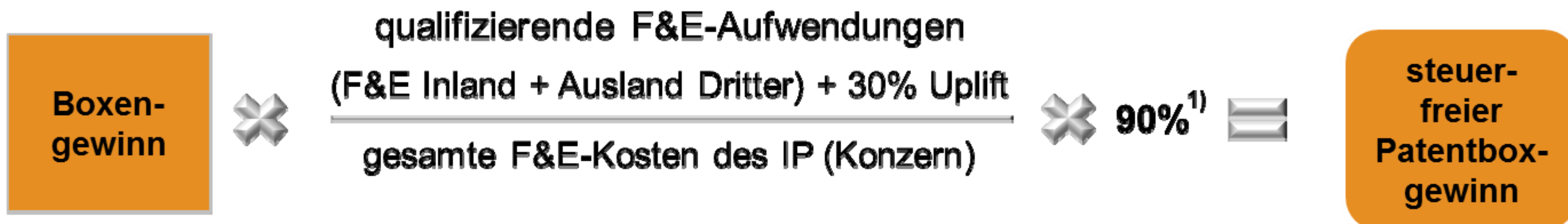
› **Practical application issues**
  - Definition “patented and similar rights”
  - Substance requirement (nexus-approach, according to OECD: see hereafter)
  - Calculation of benefitting profit (residual profit); see hereafter
  - Calculation of recaptured prior R&D expenses upon box entry.
  - What happens upon exit from Patentbox?
  - Significant documentation requirements expected

IV. Swiss Changes of Corporate Taxation with particular focus on Special Tax Regimes

Swiss corporate tax reform: Patentbox (2/3)

Substance requirement according to OECD: Nexus-Approach

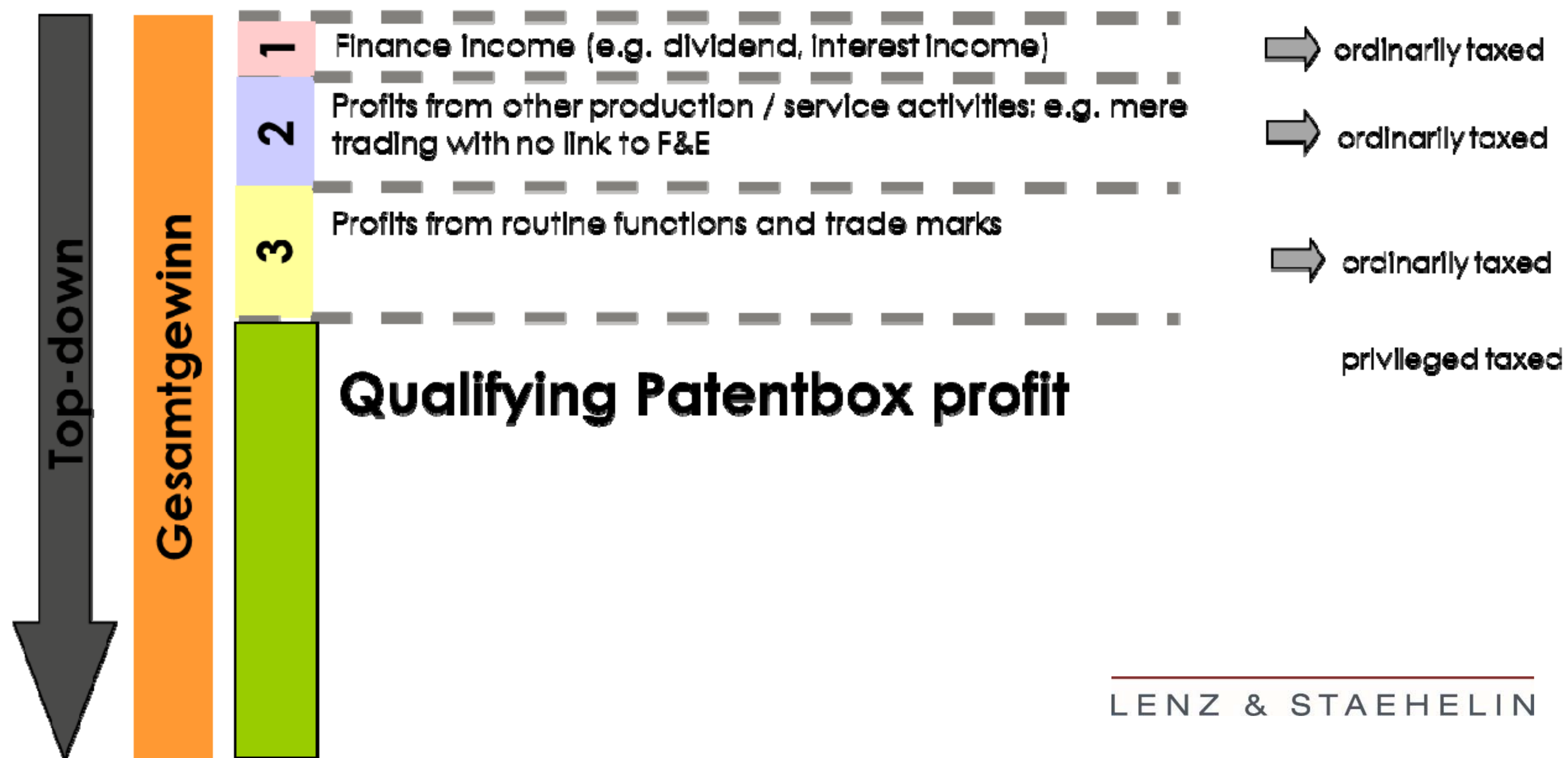
- **Target:** Determination of qualifying profit from patented and similar rights



1) Begrenzung ist durch Kanton zu bestimmen

IV. Swiss Changes of Corporate Taxation with particular focus on Special Tax Regimes

Swiss corporate tax reform: Patentbox (3/3)



V. Cross Border IP taxation (Patent Boxes etc.)

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The new German Anti-Patent Box Provision

Introduction to the *Lizenzschranke,* Prof Dr Wilhelm Haarmann, Linklaters LLP

<u>Agenda</u>

1. Key Content of the OECD BEPS Final Report on Action Item 5 on IP Regimes
2. The new German Anti-Patent Box Provision

   2.1 The *Lizenzschranke* in a Nutshell

   2.2 The *Lizenzschranke* Exemplified by a Case

V. Cross Border IP taxation (Patent Boxes etc.)

1. Key Content of the OECD BEPS Final Report on Action Item 5 on IP Regimes

> OECD proposes a fair framework for tax regimes which preferentially tax IP income like patent boxes, innovation boxes etc

> OECD nexus approach: Preferential tax treatment for IP income is conditional upon the extent of R&D activities of the taxpayer receiving benefits

> Own R&D activity (substantial activity) is measured by the respective expenditures spent by the taxpayer for its R&D activities:

$$\frac{\text{Qualifying expenditures incurred to develop IP asset}}{\text{Overall expenditures incurred to develop IP asset}} \times \text{Overall income from IP asset} = \text{Income receiving tax benefits}$$

> Qualifying expenditures do not include, e.g., expenditures on acquired IP or on outsourced R&D activity to related parties

V. Cross Border IP taxation (Patent Boxes etc.)

1. Key Content of the OECD BEPS Final Report on Action Item 5 on IP Regimes

- OECD proposes to introduce grandfathering rules for existing IP regimes not in compliance with the OECD nexus approach to remain effective until no later than 30 June 2021
- Final report does not propose a certain IP regime – participating states remain free to develop their own preferential regime for IP income compliant with the OECD nexus approach
- Final report does not give guidelines for anti-patent box legislation
- The German anti-patent box provision directly refers to the OECD nexus approach as outlined in the final report

V. Cross Border IP taxation (Patent Boxes etc.)

2. The new German Anti-Patent Box Provision

2.1 The *Lizenzschranke* in a Nutshell (1/2)

- The *Lizenzschranke* restricts the tax deductibility of royalties for IP rights to a certain extent regardless of existing double tax treaties, if
  - the respective income of the recipient is subject to a preferential and low taxation; and
  - the recipient is a related party to the payor of the royalties
- The non-deductible amount is calculated: $\frac{25\% - \text{tax rate of the royalty income in } \%}{25\%}$
- The provision applies to royalty payments in chains of more than two parties

V. Cross Border IP taxation (Patent Boxes etc.)

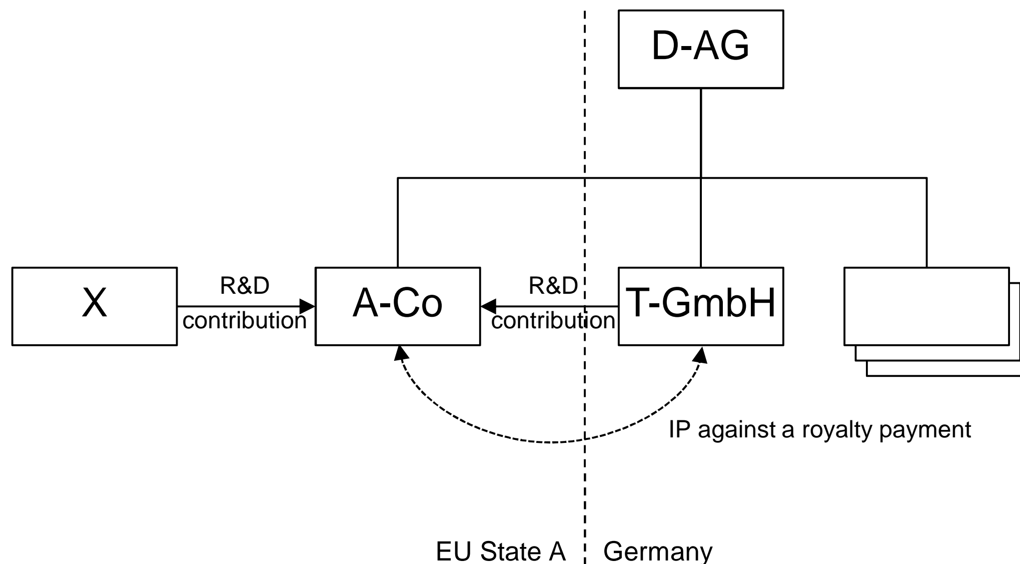
2. The new German Anti-Patent Box Provision

2.1 The *Lizenzschranke* in a Nutshell (2/2)

- It does not apply, if the preferential IP regime complies with the OECD nexus approach or if the royalty income is subject to German CFC taxation
- Permanent establishments can be both recipient and payor
- A low taxation is given, if the royalty income is taxed at a rate of less than 25%
- The *Lizenzschranke* is applicable on all respective business expenses incurred after 31 December 2017

V. Cross Border IP taxation (Patent Boxes etc.)

2.2 The Lizenzschranke Exemplified by a Case (1/2)



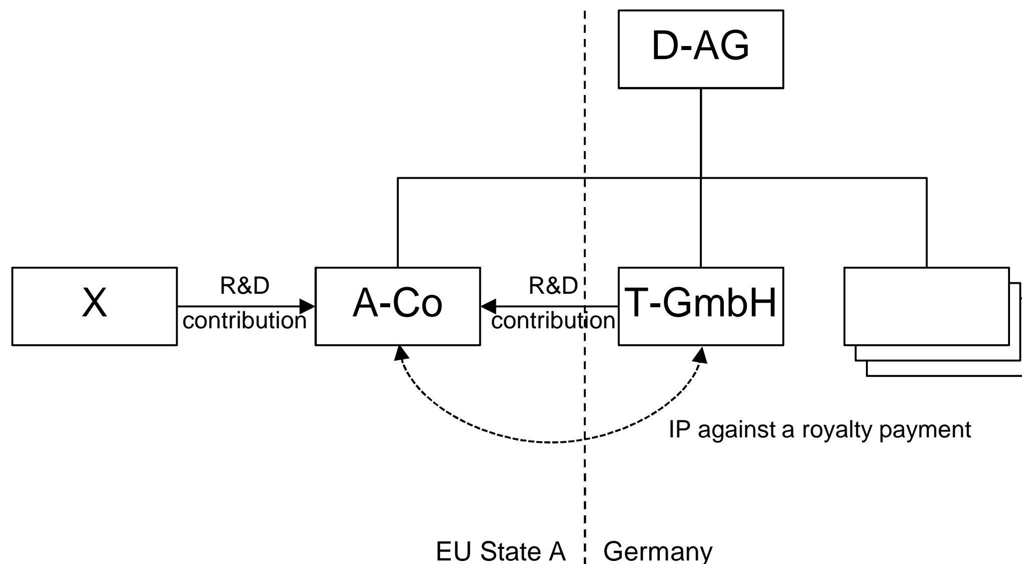
> D-AG is the parent company of the D Group

> A-Co runs an R&D facility for the D Group

> In 2007, State A introduced the innovation box, which offers a preferential tax rate for royalty income of 5% provided at least 50% of the R&D activity was carried out by the taxpayer itself (the rest can be even acquired from related parties). State A's regular tax rate is 25%.

V. Cross Border IP taxation (Patent Boxes etc.)

2.2 The Lizenzschranke Exemplified by a Case (2/2)



- A-Co has developed a new drug and fulfills the requirements for the applicability of the innovation box (the R&D activity was carried out by A-Co (50%), by T-GmbH (25%) and by the third party X (25%).
- Starting from 2015, A-Co granted a licence of the new drug to T-GmbH against a royalty payment
- Germany has concluded a double tax treaty (OECD model convention) with State A
- **Are the royalty payments of T-GmbH deductible for German tax purposes?**

V. Cross Border IP taxation (Patent Boxes etc.)

2.2 The Lizenzschranke Exemplified by a Case

Are the royalty payments of T-GmbH deductible for German tax purposes?

- Application of the *Lizenzschranke* (Section 4j para 1 and 3 German Income Tax Act)
  - The granted licence for the drug qualifies as relevant IP right
  - The innovation box of State A offers a preferential and low tax treatment of royalty income. This is the case since the tax rate on IP income differs from the regular tax rate (5% to 25%) and the tax rate on the IP income is below 25% (5%)
  - A-Co qualifies as related party to T-GmbH since D-AG holds more than 25% of the shares in A-Co and T-GmbH (Section 1 para 2 no 2 German Foreign Tax Code)
  - Art 24 para 4 of the double tax treaty between Germany and State A, which stipulates a non-discrimination for the tax deductibility of royalty payments, is not taken into account (treaty override)
  - T-GmbH can only deduct 20% of the royalty payments for German tax purposes

V. Cross Border IP taxation (Patent Boxes etc.)

2.2 The Lizenzschranke Exemplified by a Case

Are the royalty payments of T-GmbH deductible for German tax purposes? (*cont‘d*)

- Exemptions of the *Lizenzschranke* (Section 4j para 1 sentence 4 and 5 German Income Tax Act)
  - Exemption for OECD nexus approach compliant preferential IP regimes (the law directly refers to the final report of the OECD):
    The innovation box is not compliant with the OECD nexus approach since it offers the possibility that 50% of the development activity can be carried out by a related party
  - Exemption if the royalty income is subject to German CFC taxation:
    Since A-Co, as company located in an EU State, carries on genuine economic activity in State A through its R&D facility (Section 8 para 2 German Foreign Tax Code), German CFC taxation is not applicable.

V. Cross Border IP taxation (Patent Boxes etc.)

2.2 The Lizenzschranke Exemplified by a Case

Are the royalty payments of T-GmbH deductible for German tax purposes? (*cont‘d*)

> Is the *Lizenzschranke* in compliance with German constitutional law?
  > Does it violate the objective net income principle (*objektives Nettoprinzip*), the principle of democracy (*Demokratieprinzip*) and the principle of certainty (*Bestimmheitsgebot*)?

> Is the *Lizenzschranke* compliant with European law?
  > Does it violate the „Interest and Royalty Directive“ (2003/49/EC)?
  > Does the *Lizenzschranke* violate the freedom of establishment and the freedom to provide services (Art 49 and 56 TFEU)?

2.2 The *Lizenzschranke* Exemplified by a Case

2.2 The Lizenzschranke Exemplified by a Case

Are the royalty payments of T-GmbH deductible for German tax purposes? (*cont‘d*)

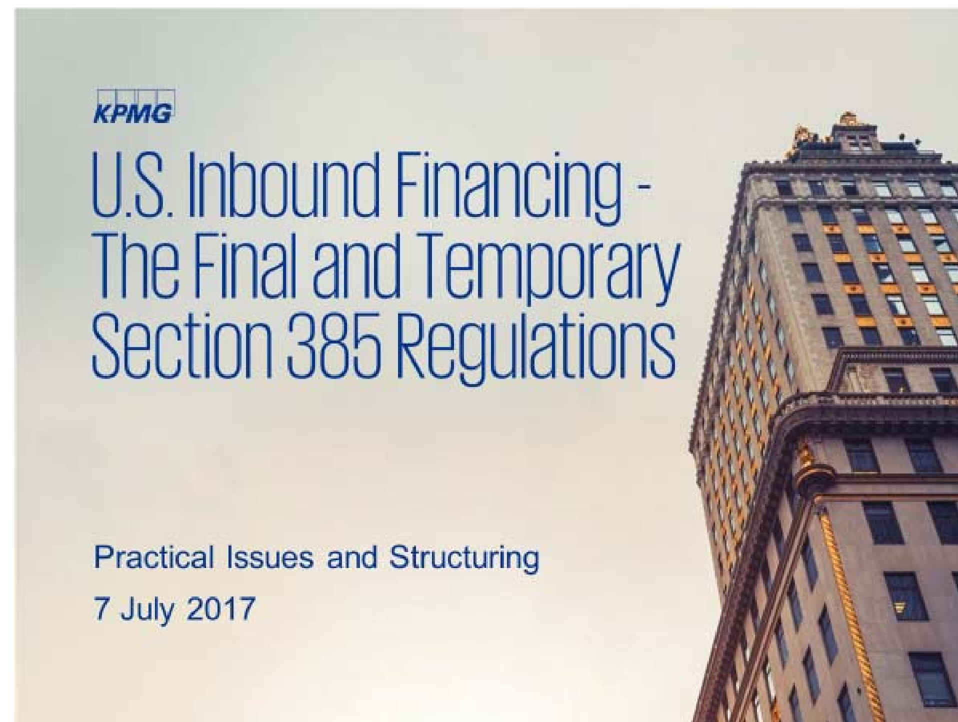
- Effective Date of the *Lizenzschranke* (Section 52 para 8a German Income Tax Act)
  - The *Lizenzschranke* is applicable on respective business expenses incurred after 31 December 2017. Hence, starting from 1 January 2018, the relevant expenses of T-GmbH, will be only tax deductible in the amount of 20%
  - OECD‘s proposal for a grandfathering period is not recognized

- Further German tax provisions in the scope of the *Lizenzschranke*
  - Section 50d para 3 German Income Tax Act (anti treaty/ directive shopping provision)
  - Section 8 para 3 sentence 2 German Corporate Tax Act (constructive dividends)
  - *Lizenzschranke* and German Trade Tax (*Gewerbesteuer*)

VI. American Taxation of Inbound Financing

Presentation by Karl Lee, KMPG

Presentation will be linked here in it‘s original format



U.S. Inbound Financing - The Final and Temporary Section 385 Regulations

Practical Issues and Structuring

7 July 2017

Notices

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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.

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Introduction

Introduction

On October 21, 2016, the Treasury Department and the IRS published final and temporary regulations under section 385 (the "Final 385 Regulations").

The Final 385 Regulations primarily affect debt issued by U.S. corporations to related parties outside their U.S. consolidated group.

The Final Regulations include rules regarding:

— Documentation of related-party debt instruments (the "Documentation Rules")

— Recharacterization of related-party debt instruments issued in certain transactions (the "Recast Rules")

Regulation package also includes:

— Temporary regulations addressing the application of the Recast Rules to:

- Certain types of debt instruments (e.g., short-term and ordinary course instruments) and debt instruments
- U.S. consolidated groups (the "Consolidated Group Rules")

— Proposed regulations regarding partners' share of recourse liabilities

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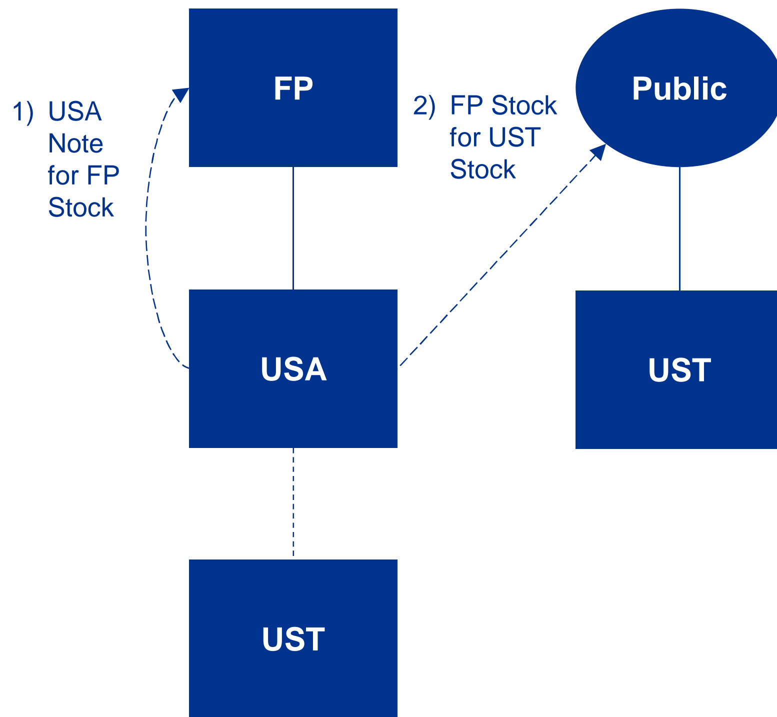
Problem Transaction #1 – Post-Inversion Purchase of FP Stock for a USA Note



Facts

1) On Date A in Year 1, USA issues USA Note, a Debt Instrument, to FP in exchange for FP stock
2) On Date B in Year 1, USA transfers the FP stock to UST's shareholders, who are not members of FP's expanded group, in exchange for all the stock of UST.

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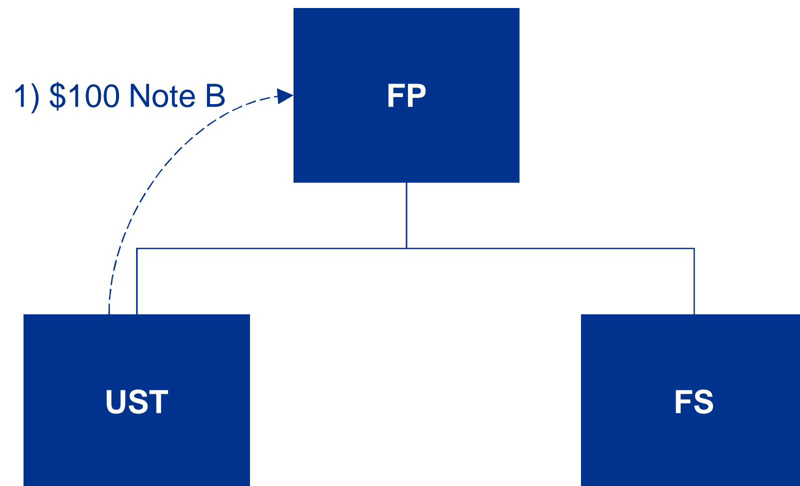
Problem Transaction #2 – Post-Inversion Dividend of a Debt Instrument



Facts

1) FP wishes to push debt into a US subsidiary without advancing new funds.
2) UST distributes Note B, a Debt Instrument with a value of $100, to FP.
3) Distribution qualifies as a dividend to the extent of UST's current and accumulated earnings and profits (E&P).
   - If UST has no E&P distribution is generally not subject to US WHT.
   - If UST has E&P, dividend WHT can be decreased or eliminated under tax treaty between the US and FP's country.
4) If the $100M USD note were respected as indebtedness for US tax purposes, UST's payments of interest on the loan could be deductible and potentially erode the US tax base (subject to earnings stripping rules).

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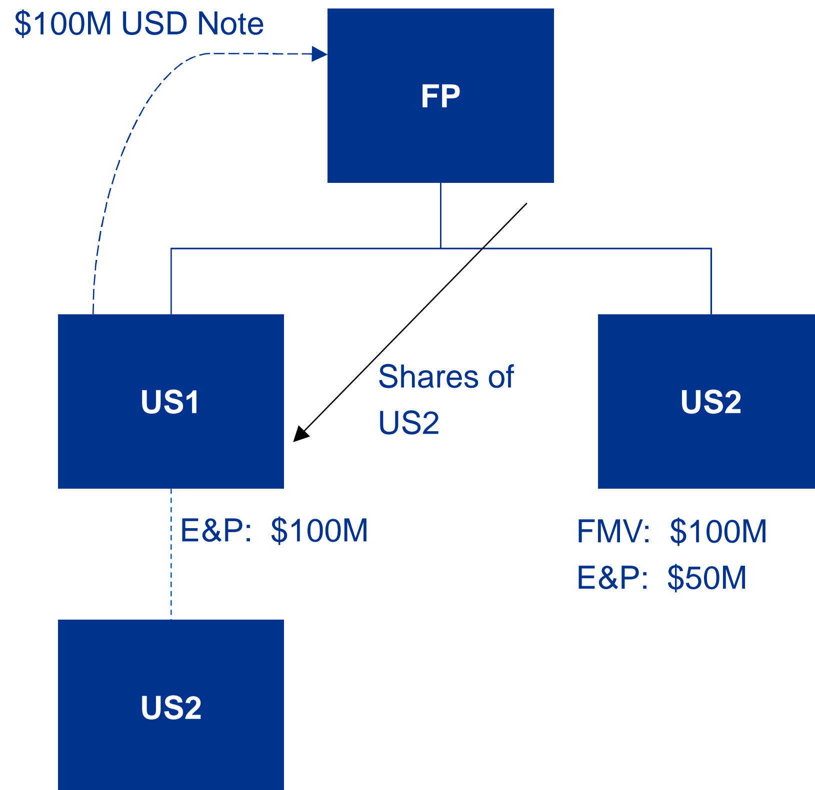
Problem Transaction #3: Acquisition of Brother-Sister Company in Exchange for a Debt Instrument



Facts

1) FP sells US2 shares to US1 solely in exchange for an instrument of indebtedness.

Analysis

- FP's sale of US2 shares to US1 in exchange for a note should be characterized as a Section 304 transaction for US tax purposes.
- US1's transfer of $100M Note to FP is treated as a dividend distribution entirely sourced from US1's E&P.
- Assuming that FP is eligible for 0% dividend WHT under an applicable US tax treaty, no US tax should result from the transaction.
- If the $100M USD note were respected as indebtedness for US tax purposes, US1's payments of interest on the loan could be deductible and potentially erode the US tax base (subject to earnings stripping rules).

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Final Section 385 Regs

Key Definitions

- "**Expanded Group**" (EG)
  - Includes foreign corps, RICs, REITs, insurance companies, tax-exempts, DISCs (but not S corps)
  - 80% vote or value
  - Ownership can be direct or indirect
  - Preferred Stock is excluded
- "**Expanded Group Interest**" (EGI) – Relevant to the Documentation Rule
  - An "applicable interest"
  - Issuer/holder are members of the same EG (or are DREs with regarded owners that are members of the same EG)
- "**Covered member**"
  - A member of an EG that is a U.S. corporation
- "**Covered debt instrument**" (CDI) – Relevant to the Recast Rules
  - Debt instrument issued after April 4, 2016 (with certain limited exclusions), and
  - Issued by a covered member (other than certain regulated financial or insurance companies)

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Documentation Rules

What do the Documentation Rules apply to?

— Generally, every kind of debt issuance by certain U.S. companies to non-U.S. affiliates in a "Medium or Large-Sized" expanded group:

- Intercompany debt of foreign issuers is exempt
- Not only formal loan agreements -- Documentation Rules apply to ALL "in form" intercompany debt, even if just a trade payable and/or documented as debt in a ledger, accounting system and no legal instrument governs the debt instrument
- The rules apply separately with respect to each debt instrument

— What is a "Medium or Large-Sized" corporate group?

- A corporate group that satisfies at least one of the following requirements:
  - A member has publicly traded stock,
  - Aggregate annual revenue is more than $50 million, or
  - Total assets are more than $100 million.
- Determination is made by looking at one or more financial statements of the members of the EG.

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Documentation Rules

What do the Documentation Rules require?

— Impose minimum written documentation, financial diligence and behavioral requirements that must be observed with respect to an EGI:
  - Unconditional obligation to pay a determinable sum certain
  - Creditor's rights
  - Reasonable expectation of ability to repay EGI
  - Actions evidencing debtor-creditor relationship
  - Consistency requirement

— Terms and conditions of written loan documentation alone not sufficient to satisfy Documentation Rules requirement → Actual performance of the debtor and note holder also considered

— Maintenance rule

— Special rules for revolvers, umbrella agreements, cash pool and similar arrangements

What happens if the Documentation Rules are not satisfied and no exception applies?

— The debt instrument at issue will be recharacterized as stock.

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Documentation Rules

When do the Documentation Rules apply?

— Generally apply to debt issued on or after January 01, 2018
  - Thus, a taxpayer must have documentation in place by the due date (as extended) of its tax return for its TYE 2018 (e.g., September 15, 2019)
  - Taxpayers should use the time to implement systems and controls for compliance
  - Taxpayers should implement “best practices” currently without regard to the effective date

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Recast Rules

What are the Recast Rules?

- The Recast Rules recharacterize as stock related party debt instruments issued in a transaction (or series of transactions) that does not result in new investment in U.S. operations.
- Two primary operating rules:
  - "General Rule"
  - "Funding Rule"
- Special rules for U.S. consolidated groups

What Do the Recast Rules Apply to?

- The Recast Rules apply to CDIs
  - Debt instruments
  - Issued after April 04, 2016
  - Issued by a covered member (i.e., "U.S. corporations" and "controlled partnerships")

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Recast Rules

What is the "General Rule"?

— The General Rule targets three "suspect transactions" by which a CDI is recharacterized as stock to the extent issued to an EG member:

  - in a distribution (other than an exempt distribution) (example 2)
  - to acquire stock in an EG member (other than in an exempt exchange) (example 3)
  - as boot in an intra-EG asset reorganization

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Recast Rules

What is a "Funding Transaction"

— The Funding Rule generally applies to recharacterize as stock CDI issued to an EG member in exchange for property that is treated as funding a "defunding" acquisition or distribution outlined above, *to the extent* of the defunding

- ***Per se* funding rule:** a CDI is treated as funding an acquisition or distribution (thus recharacterized as stock) *to the extent* the issuer issues the CDI within the *per se* period that applies to the defunding acquisition or distribution
  - The *per se* period begins 36 months before the date of a defunding acquisition or distribution (but not prior to April 04, 2016), and ends 36 months after the date of the defunding acquisition or distribution
- **Principal purpose funding rule:** a CDI is treated as funding a defunding acquisition or distribution (thus recharacterized as stock) if it is issued outside of the *per se* period with a principal purpose to fund the defunding acquisition or distribution

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Recast Rules

What Exceptions to the Recast Rules Apply?

— Key Exceptions to the Recast Rules
  - Threshold exception ($50 million threshold)
  - U.S. Expanded Group Earnings and Profits (“E&P”) exception
    - The exception now applies to the amount of all E&P generated in all tax years ending on/after 05 April, 2016, while in the EG
    - Look-through rule for dividends applies
  - Qualified short-term debt instruments exception
    - Short-term funding arrangements
    - Ordinary course loans
    - Interest-free loans
    - Deposits with a qualified cash pool header
  - Certain acquisitions of subsidiary stock exception
  - Qualified contribution netting exception

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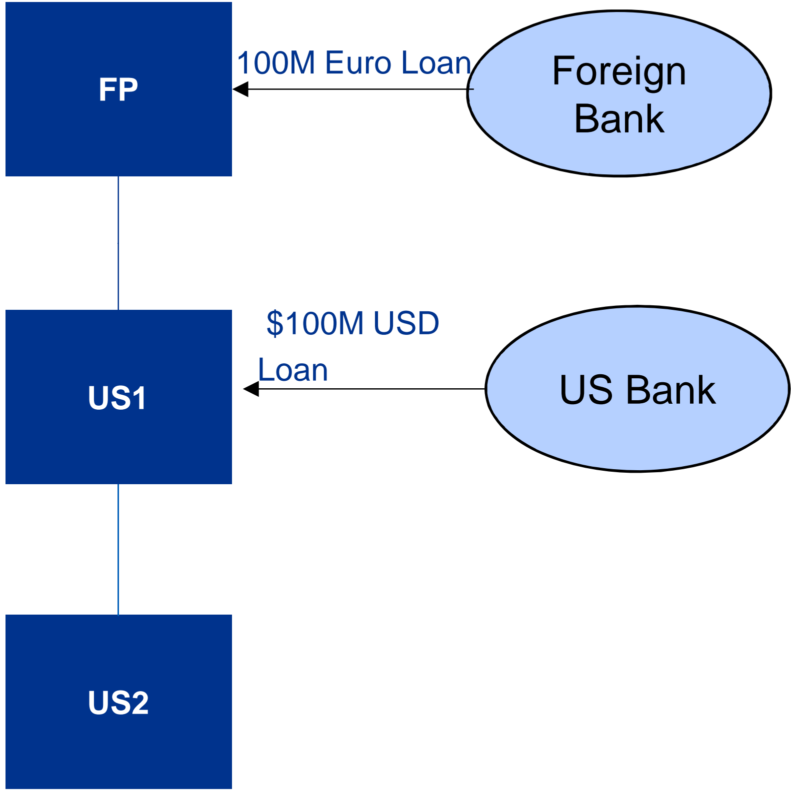
Potential Structuring Strategies

Example 1: External Financing



Facts

1) FP borrows $100M cash from a third-party foreign bank (“FP Loan”).
2) US1 borrows $100M cash from a third-party bank (“US1 Loan”).

Analysis

- Because the US1 Loan is between US1 and an entity outside US1’s EG, the Section 385 Recast Rules should not apply to potentially recharacterize the US1 Loan as equity.

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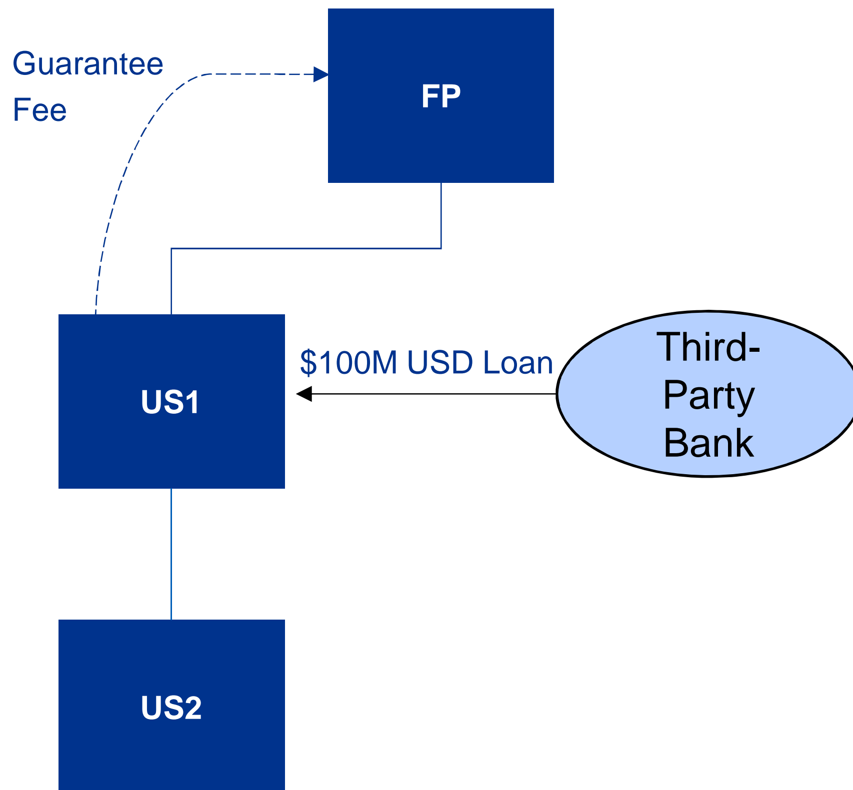
Example 2: Foreign Affiliate Guarantor



Facts

1) US1 borrows $100M cash from a third-party bank ("US1 Loan"). Pursuant to the terms of the creditor's agreement, FP is a guarantor of the US1 Loan.
2) US1 pays periodic loan guarantee fees to FP for guaranteeing repayment of the US1 Loan

Analysis

- Provided that US1 is able to support the third-party loan obligation independent of FP's guarantee, the US1 guarantee payments to FP should be respected as deductible payments (subject to certain limitations under earnings stripping rules) by US1.
- Because the US1 Loan is between US1 and an entity outside US1's EG, the Section 385 Recast Rules should not apply to potentially recharacterize the US1 Loan as equity.
- Related-party guarantee fees are generally excluded from the scope of the Section 385 Recast Rules.

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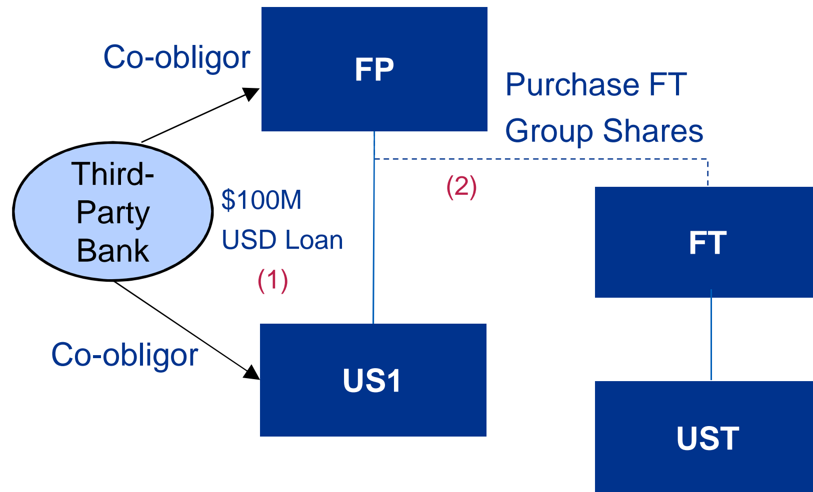
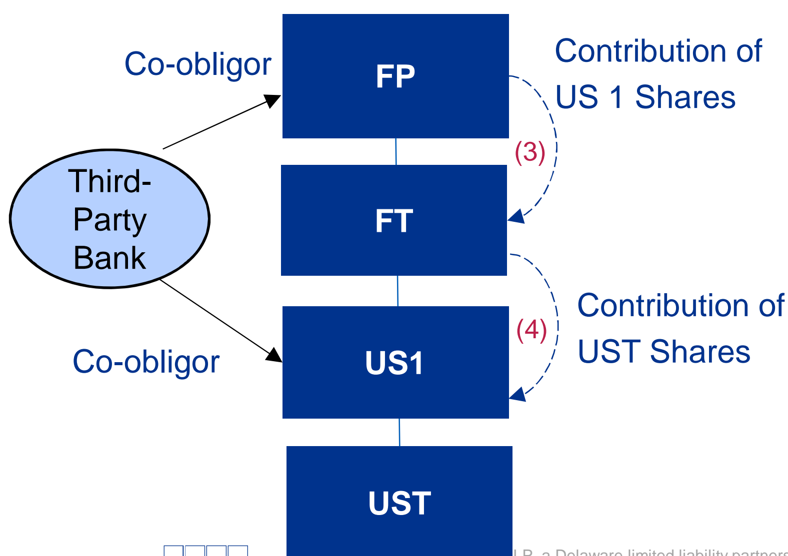
Example 3: Co-obligor Arrangement





Facts

1) Third-party bank lends $100M to FP and US1 as co-obligors. The cash proceeds of the loan are transferred entirely to FP.
2) FP purchases FT Group from an unrelated purchaser in exchange for $100M cash.
3) FP transfers 100% of the US1 shares to FT solely in exchange for FT shares.
4) FT transfer 100% of the UST shares to US1 solely in exchange for US1 shares.

Analysis

- US1 and FP are treated as co-equal borrowers of the $100M loan, even though all of the loan proceeds were transferred directly to FP.
- Thus, US1's payments to third-party bank on the $100M may be considered deductible for US tax purposes to the extent that such payments are considered payments of interest on the outstanding debt.

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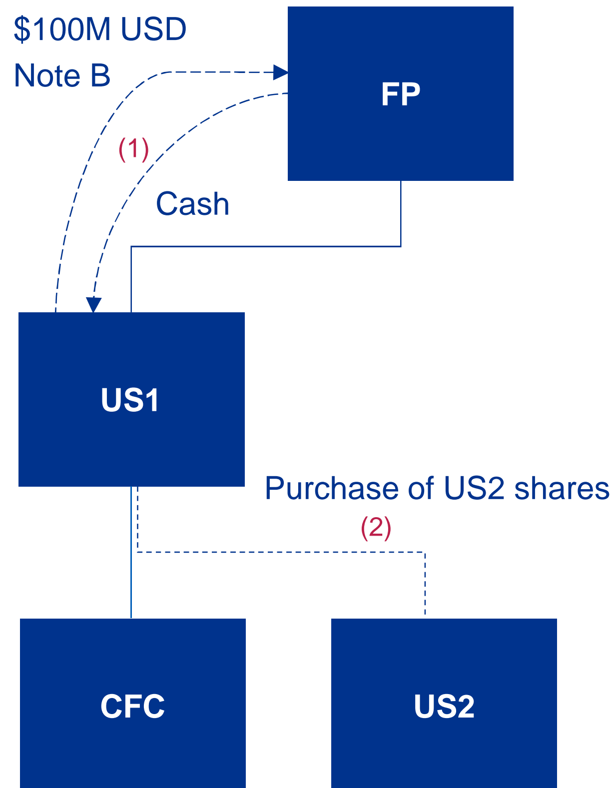
Example 4: Advance Cash To US Acquisition Co to Finance M&A Transaction



Assumption

US1 has $0 post-04 April 2016 US earnings and profits.

Facts

1) On 01 January 2017, FP contributes $100M cash to US1 in exchange for loan note ("US1 Note").
2) On 30 June 2017, US1 acquires US2 stock from a third party in exchange for $100M cash.

Analysis

- Since US1 issued Note B to FP in exchange for actual property (e.g., cash), the General Rule should not apply to recharacterize Note B as equity.
- Provided that the US1 monitors its distributions and certain acquisitions between itself and members of its EG during the per se period, the Funding Rule may not apply to recharacterize Note B as equity.

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VII. Exchange of Tax Rulings

VII. Exchange of Tax Rulings

a) The German experience

b) The Swiss experience

c) The US experience

VII. Exchange of Tax Rulings

b) The Swiss experience

International Exchange of Tax Rulings (1/2)

Material Aspects

- **Tax rulings** (i.e. advance information from tax office on an ongoing tax treatment); regarding corporate income taxes and Swiss withholding taxes
- **Effective January 1, 2018** onwards (confirmed after January 1, 2010)
- **Regarding tax regimes**
  - **Preferential tax regimes**: holding-, mixed-, principal-, IP-box companies
  - **Determination of transfer pricing (unilateral)**
  - Unilateral downward adjustment of taxable profits
  - **Permanent establishment (existence and profit allocation)**
  - Related party conduit arrangements
- **Are exchanged with other countries:** reciprocity- and speciality principles apply
  - Parent and ultimate parent company country / Group company country / Head-office country

VII. Exchange of Tax Rulings

b) The Swiss experience

International Exchange of Tax Rulings (2/2)

Procedural aspects

- Legal basis
  - Convention on Mutual Administrative Assistance in Tax Matters, MAC (Amtshilfe-Ü): Art. 7
  - Steueramtshilfegesetz, StAhiG: Art. 22a-d
  - Steueramtshilfeverordnung, StAhiV: Art 5 ff.

- Taxpayers are currently asked whether tax ruling shall continue to apply
  - Terminated tax rulings are not exchanged
  - Content of continued tax rulings must be summarized in a template
  - Template (not the ruling itself) will be exchanged with other countries in 2018
  - Swiss federal tax administration is competent authority
  - Taxpayer must be heard / can appeal

VIII. Differentiation between legality and legitimacy in tax law

VIII. Differentiation between legality and legitimacy in tax law

a) Legal – Illegal/ legitimate – Illegitimate

b) Is abuse illegal or illegitimate?

c) Is aggressive tax planning illegitimate?

Thank you for staying to the very end!

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