U.S. Tax Reform

Key Considerations for German Multinational Groups

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Program agenda

1	**Overview** — High level U.S. budget impacts — Key provisions of US tax reform
2	**More details on key provisions for U.S. inbound companies** — Earning stripping rules — BEAT — FDII
3	**Practical illustration of U.S. tax reform's impact on U.S. inbounds and potential considerations**

Overview

The numbers tell the story

Revenue impact[1]	Final bill provisions
$1,349	Reduce corporate rate to 21%
$415	Pass-throughs
$86.3	Temporary, limited expensing
$212	Territoriality
$64	Domestic IP Incentive (foreign-derived intangible income ("FDII") deduction)
$339	Mandatory repatriation
$150	Base erosion and anti-abuse tax ("BEAT")
$113	Super Subpart F (incl. global intangible low-taxed income ("GILTI") inclusion)
$253	Interest expense reforms
$201	NOL reform
$98	Repeal section 199

1. Based on scores provided by the Joint Committee on Taxation. U.S. Dollar amounts are in billions.

Cornerstone provisions for U.S. inbounds

Lower Corporate Rate – 21%

Participation Exemption and Mandatory Repatriation Tax

Immediate Expensing But Strengthened Interest Expense Limitation Rule

Net Operating Loss (“NOL”) Limitation Modifications

Base Erosion Anti-Avoidance Tax (the “BEAT”)

New Global Intangible Low Taxed Income (“GILTI”) Tax vs. Deduction for Foreign Derived Intangible Income (“FDII”)

Key provisions

Key provisions for U.S. inbound companies

Key provisions – General corporate tax measures		Effective date
Immediate expensing	100% expensing for certain qualified capital expenditures (both new and certain acquired 'used' property) for five years. Also includes House version's phase-down for property acquired before 27/09/2017 Election to 'opt out' of immediate expensing for first year only Not applicable to goodwill, intangibles, or real property	Generally, qualified property placed in service after 27/09/2017
Strengthened interest expense limitation	Net business interest expense limitation – based on 30% EBITDA through tax years beginning before 1/1/2022, and thereafter based on 30% EBIT Applies to unrelated and related party debt Indefinite carryforward of disallowed expense allowed; prior-law disallowed expense carries over No grandfathering of existing debt U.S. consolidated group treated as one entity; separate U.S. consolidated groups not aggregated **Group disproportionate debt rule ("110% Rule") *excluded from Final Bill***	Tax years beginning after 31/12/2017

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Key provisions for U.S. inbound companies

Key provisions – Int'l tax measures affecting inbounds		Effective date
Base erosion anti-abuse tax ("BEAT") on related party payments (1/2)	Broadly, a minimum 10% tax imposed on U.S. companies having certain deductible 'base erosion payments' made to related non-U.S. companies — Lower 5% phase-in rate applies to 2018 tax year — For tax years beginning after 31/12/2025, 12.5% rate of tax *(1% increase for affiliated groups that include banks and/or securities dealers)* Minimum tax liability equals excess of 10% (or other rate) of the U.S. company's 'modified taxable income' ("MTI") over its regular U.S. tax liability reduced by certain allowable credits (but not R&D and certain renewable energy credits) — Harsher minimum tax liability formula to apply after 2025 Broadly, MTI is taxable income plus certain tax benefits for 'base erosion payments' and NOLs allocable to such payments — Base erosion payments include (i) deductible payments and (ii) depreciable/amortizable amounts (and exclude non treaty-rate reduced portion subject to U.S. gross-basis WHT) — Generally exclude COGS payments (except to expatriated companies), but include allowable interest expense and service payments (unless service cost method regulations generally satisfied) Only applies to large taxpayer groups, but *relatedness based on significantly lower common ownership threshold* (only 25%).	Tax years beginning after 31/12/2017

Key provisions for U.S. inbound companies (continued)

<table>
<tr><th colspan="2">Key provisions – Int’l tax measures affecting inbounds</th><th>Effective date</th></tr>
<tr><td>Base erosion anti-abuse tax (“BEAT”) on related party payments
(2/2)</td><td>Two-tier trigger applies to determine when BEAT applies:
— First, determine if there is an Applicable Taxpayer (applied based on global relatedness test), and
— Second, determine the extent to which BEAT tax liability exceeds the regular tax liability (applied based on U.S. consolidated group principles)

Applicable Taxpayer Threshold Tests:
— Groups with annual average global U.S. gross receipts ≥ $500M over 3 years (Gross receipts of non-U.S. corps are included only to the extent of U.S. effectively connected income), and
— Base erosion % (base erosion deductions/total allowable deductions) ≥ 3% (2% base erosion percent threshold for banks/securities dealers)

High-level BEAT tax liability formula:
— BEAT Liability = ([10%] Modified Taxable Income (“MTI”) – R&E credits – 80% certain section 38 credits) – (21% Taxable Income – all credits)
— MTI = Taxable Income + Base erosion tax benefits + ((Base erosion %) x section 172 NOL deduction for year)</td><td>Tax years beginning after 31/12/2017</td></tr>
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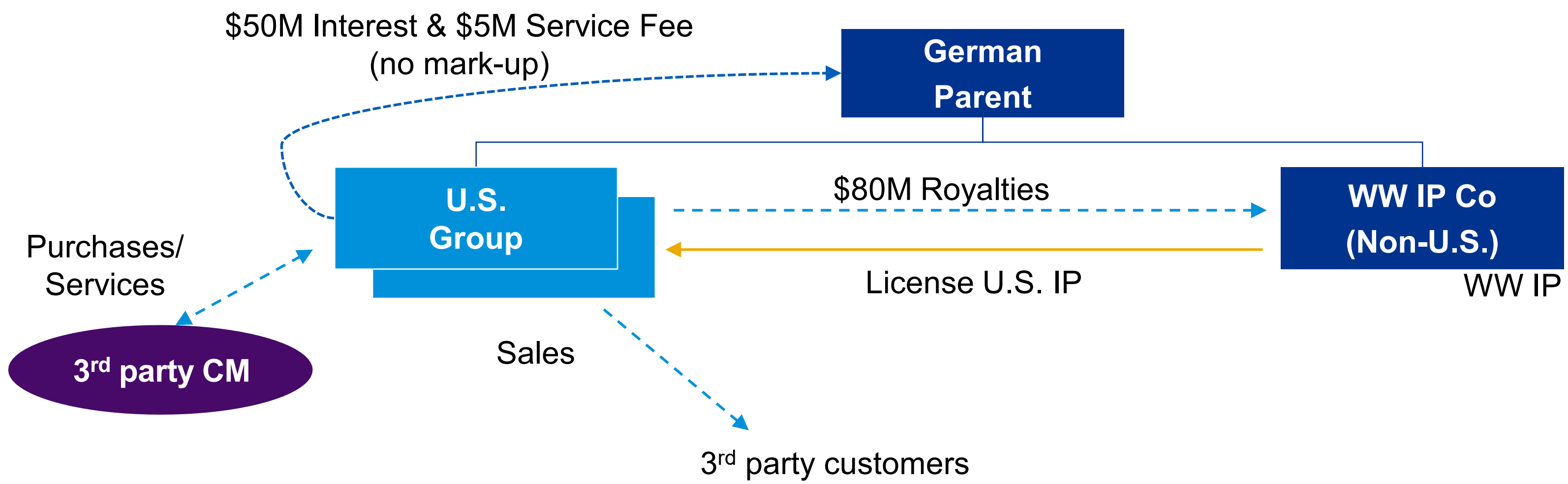
The BEAT goes on… Illustrative application of the BEAT

Example 1: Illustrative transaction flows



Background facts/assumptions

— U.S. Group's gross receipts for calendar tax year ends 2016 thru 2019 are $425M, $500M, $600M, and $500M, respectively

— In 2019, U.S. Group makes the following related party payments:

- $50M interest paid to German Parent ($5M limited under new section 163(j))
- $80M royalty payments to WW IP Co
- $5M shared services fees that qualify for use of the services cost method (and no mark-up on services) to German Parent

— No U.S. Group depreciation/amortization deductions

— US Group has $100M of COGS in 2019

— U.S. Group's 2019 Taxable Income = $100M

— Assume no U.S. withholding tax on all payments

The BEAT goes on… Illustrative computation of the BEAT (continued)

BEAT computation illustration – 2019 tax year

- U.S. Group is within the scope of potential application of BEAT for its 2019 tax year because:
  - (i) U.S. Group's aggregate annual average gross receipts for tax years ending 31/12/2016 thru 31/12/2018 are in excess of $500M, and
  - (ii) Base erosion percentage:

$$\frac{\text{US Group's Base Erosion Tax Benefits}}{\text{Total Allowable Deductions}} = \frac{\$45\text{M allowable interest expense} + \$80\text{M royalty payments}}{\$300\text{M}} \geq 3\%$$

- BEAT liability is the excess of (a) 10% of U.S. Group's Modified Taxable Income (MTI) over (b) U.S. Group's regular tax liability (assuming no credits)
  - Here, *MTI* = (i) *Taxable Income* ($100M) *plus* (ii) aggregate *Base Erosion Tax Benefits* ($125M) ((i) and (ii) combined, $225M)
  - U.S. Group's regular tax liability = $21M ($100M x 21% corp tax rate)

- Thus, U.S. Group is subject to **$1.5M BEAT liability** in 2019 (e.g., (10% x $225 million = $22.5M) less $21M), which is *in addition to* U.S. Group's $21M regular U.S. federal tax liability

Key provisions for U.S. inbound companies

Key provisions – Int'l tax measures affecting inbounds		Effective date
Reduced rate for foreign-derived intangible income (FDII) of U.S. corporations (1/2)	Tax-deduction for certain foreign-derived income of U.S. corporations (FDII) (U.S.-style patent box or BAT-light?) 37.5% deduction (13.125% ETR) for U.S. entity's 'foreign-derived intangible income' — For taxable years beginning after 31/12/25, the deduction drops to 21.875% (16.406% ETR) — FDII Deduction + GILTI deduction are together capped at taxable income for the year Applies to income from export sales or export services Deemed intangible income eligible for deduction determined as excess of certain gross income over deemed 10% return on average tax basis of certain tangible assets **Can apply even if no intangibles are owned!** Certain related-party anti-abuse rules apply — Generally, a 'sale' of property to a related non-U.S. person will not qualify for FDII benefits unless the property is either (i) ultimately sold to an unrelated non-U.S. person for foreign use, or (ii) used in connection with property sold to, or services provided to, an unrelated non-U.S. person, for foreign use — Generally, income received from services provided to a related party not located in the United States is not eligible for the FDII deduction unless it is established that the related party does not provide substantially similar services to persons located in the United States Subject to possible WTO challenge? — Inconsistent with patent box rules; possible reactive measures from EU? — If German entity pays royalties to US group that are subject to a FDII deduction the expense may be (partially) denied under German anti-patent-box rules (i.e. Para. 4j EStG).	Tax years beginning after 31/12/2017

Key provisions for U.S. inbound companies (continued)

<table>
<tr><th colspan="2">Key provisions – Int'l tax measures affecting inbounds</th><th>Effective date</th></tr>
<tr><td>Reduced rate for foreign-derived intangible income (FDII) of U.S. corporations (2/2)</td><td>High-level FDII Formula
FDII = Deemed Intangible Income ("DII") x Foreign Derived Deduction Eligible Income ("FDDEI") / Deduction Eligible Income ("DEI")

<u>DEI</u>: Gross income less
— Subpart F income
— GILTI
— Foreign Branch Income
— Dividends from CFCs
— Other (financial services income, domestic oil and gas extraction income)
— Deductions (including taxes) properly allocated to such income

<u>DII</u>: DEI – Deemed tangible income return ("DTIR")
— <u>DTIR</u> = 10% x QBAI
— <u>QBAI</u>: domestic corporation's basis in depreciable tangible property

<u>FDDEI</u>: DEI received from export sales and services
— Sales (including leases and licenses) to foreign person for foreign use
— Services provided to persons or with respect to property outside the United States
— Special limitation rules for related / intermediary sales and services</td><td>Tax years beginning after 31/12/2017</td></tr>
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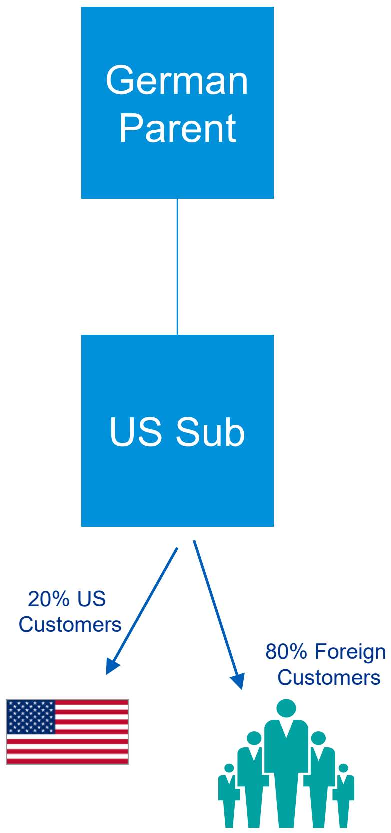
Taxation of FDII – Computation Illustration



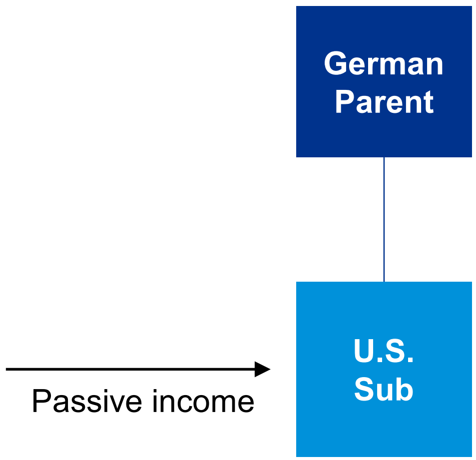
Facts and Assumptions:

- A German automotive group has a 100% subsidiary in the US in the legal form of a corporation which undertakes the production of one of the group's car series. The cars are sold by the US corporation to worldwide third party customers.
- The profit of the US corporation from the sale of the cars to third party customers amounts to USD 1,000. 80 % of the cars are sold to third parties outside the United States. Apart from that the US corporation has no further income.
- The expenses in relation with the production of the cars sold amount to USD 700 not including any non-deductible expenses.
- The US corporation owns among others production plants, machines, factory and office equipment as tangible assets (which are subject to depreciation according to sec. 167 of the US tax code). The average of the aggregate adjusted bases (by using the alternative depreciation system under sec. 168(g)) as of the close of each quarter in TY 18 in the US corporation's tangible property used in the production of the cars amounts up to USD 400 (= Qualified Business Assets Investment (QBAI)).

Taxation of FDII – Computation Illustration (cont'd)

Step	Description	Results
1. Calculate Deduction Eligible Income (DEI)	Gross income – allocable expenses (including taxes) = DEI	1000 – 700 = 300
2. Calculate the Deemed Intangible Income (DII)	A. Routine return (10%) on QBAI, based on quarterly average tax bases of qualifying assets used in the relevant business activities	10% x 400 = 40
	B. DEI – the QBAI Routine Return = DII	300 – 40 = 260
3. Calculate Foreign-derived DEI (FDDEI)	DEI x percentage of income from qualifying foreign activities = FDDEI	300 x .80 = 240
4. Calculate Foreign-Derived Intangible Income	FDEII x DII / DEI = FDII	240 x 260 / 300 = 208
5. Calculate the FDII deduction	Applicable rate x FDII = deduction amount (Rate is 37.5% from 2018-2025, and 21.875% from 2026 on)	.375 x 208 = 78
6. Calculate the US tax liability	A. Tax on FDII is FDII – FDII deduction x 21% (resulting in an effective rate of 13.125%)	208 – 78 = 130 x .21 = 27.3
	B. US income is taxed at 21%	60 x .21 = 12.6
	C. Remaining income, attributable to return on QBAI, taxed at 21%	32 x .21 = 6.72
	Total US tax liability	27.3 + 12.6 + 6.72 = 46.62

Impact on German CFC Rules



Overview

- Under German CFC Rules, if a controlled foreign company derives low taxed passive income, the German Parent is subject to German CFC taxation with this income. Low taxed is defined as an effective tax rate of less than 25%.
- The following factors will have to be considered when determining low taxation:
  - Federal tax rate in the US is now reduced to 21%
  - State and local income taxes may bring effective tax rate above 25%
  - Immediate expensing and FDII deduction may reduce effective tax rate significantly below 25%
- Detailed analysis may be required, in particular with respect to income generated by trading activities and rendering of services.

Possible value chain considerations post U.S. tax reform

Illustration of potential U.S. inbound considerations in U.S. tax reform environment

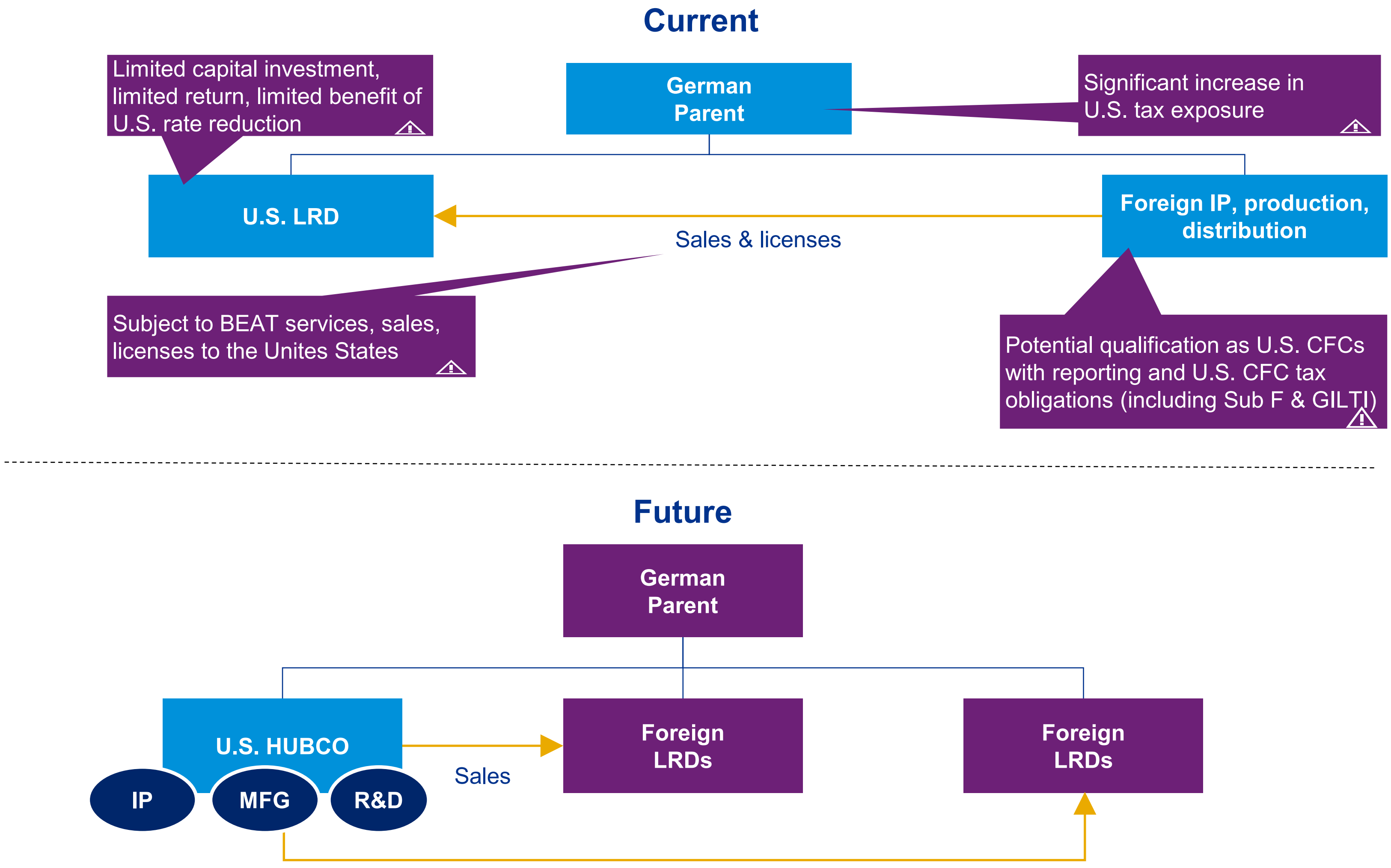


Illustration of potential U.S. inbound considerations in U.S. tax reform environment (continued)

Overview

- German Parent, the ultimate corporate parent of a multinational corporate group, has IP, manufacturing and R&D offshore and sells to the U.S. market via a captive U.S. LRD
- In the future state, the company concludes it would be beneficial to move certain of its IP, manufacturing, and R&D into new regional U.S. HubCo

U.S. tax reform impact

- 21% corporate tax rate much more competitive, especially when combined with other incentives
- Immediate expensing of capital assets and survival of R&E credit incentivizes U.S. expansion
- Lower tax rate attributable to U.S. IP under FDII regime could encourage U.S. production and export model and R&D (rate not as generous as certain EU patent box but applies more broadly perhaps)
- BEAT minimization planning could also lead to on-shoring IP and production
- Capital structure considerations to limit cost of interest expense disallowance and BEAT

- HOWEVER: How long will it last? Political uncertainty and potential budget deficit concerns…

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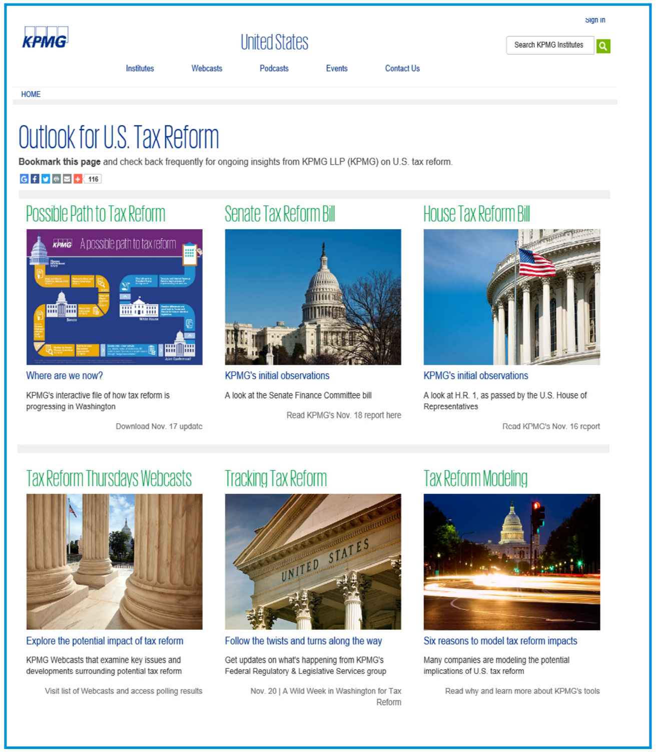
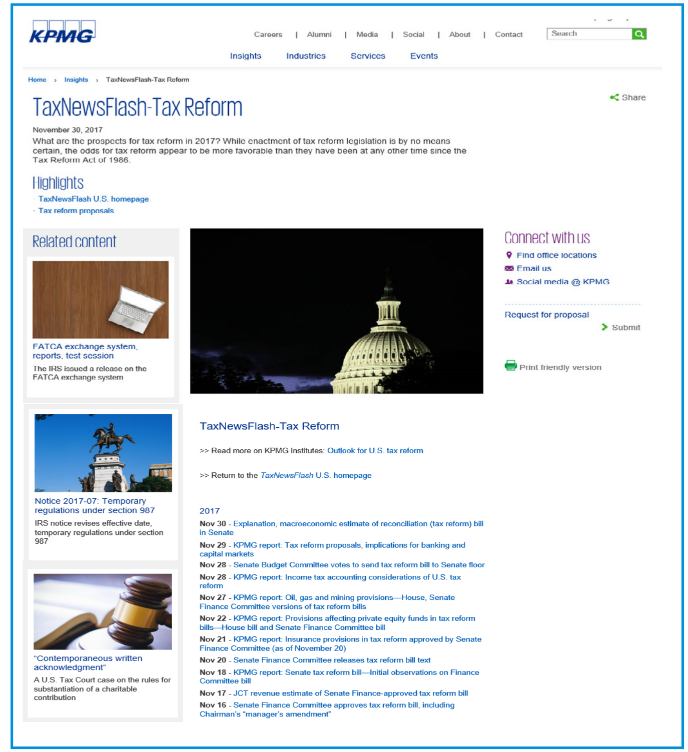


Link:

http://www.kpmg-institutes.com/institutes/tax-governance-institute/articles/campaigns/tax-reform-under-trump.html

TaxNewsFlash – U.S. Tax reform portal



Link:

https://home.kpmg.com/us/en/home/insights/2016/12/tnf-tax-reform-expectations-for-2017.html

Thank you

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