The life cycle of a transaction – mitigating risks while delivering numbers that support planning
Disclaimer

► EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com.

► Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

► This presentation is © 2014 Ernst & Young LLP. All rights reserved. No part of this document may be reproduced, transmitted or otherwise distributed in any form or by any means, electronic or mechanical, including by photocopying, facsimile transmission, recording, rekeying, or using any information storage and retrieval system, without written permission from Ernst & Young LLP. Any reproduction, transmission or distribution of this form or any of the material herein is prohibited and is in violation of US and international law. Ernst & Young LLP expressly disclaims any liability in connection with use of this presentation or its contents by any third party.

► Views expressed in this presentation are not necessarily those of Ernst & Young LLP.
Circular 230 disclaimer

► Any US tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions.

► These slides are for educational purposes only and are not intended, and should not be relied upon, as accounting advice.
Today’s presenters

Michael Medley  
Ernst & Young LLP  
Iselin, NJ

James Sauer  
Ernst & Young LLP  
New York, NY

Tina Minozzi  
Ernst & Young LLP  
New York, NY

Sue Lippe  
Ernst & Young LLP  
Chicago, IL
In the process on the left (typical case), the planning and all other elements are discrete and loosely connected; people, information and technology are not optimized to reduce risk or maximize efficiency.

On the right (best case), all elements of a transaction are interconnected; mitigating risk, providing advanced learning opportunities for people and the potential for process efficiencies as data is shared throughout the planning lifecycle.
Key elements of quantitative analysis

► C. A. M. P.

► Compliance
  ► Forms 5471, 8865 and 8858, 1118, white paper disclosure statements

► Attributes
  ► Earnings and profits (E&P), Tax pools, basis, foreign tax credit (FTC) limitation/carryover, dual consolidated losses (DCLs), overall foreign loss (OFL)

► Modeling
  ► Planning
  ► Tax reform

► Provision
  ► Financial statement impact
### Life cycle – timeline

<table>
<thead>
<tr>
<th>Feasibility</th>
<th>Implementation</th>
<th>Quarter closes (Months 3, 6, 9)</th>
<th>Year-end</th>
<th>Tax return</th>
<th>Audit/ settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(M)odeling</strong></td>
<td><strong>(P)rovision</strong></td>
<td><strong>(C)ompliance</strong></td>
<td><strong>(A)tributes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Configure models, input tax return/forecast data, project E&amp;P, basis and baseline foreign source income (FSI), and quantify OFL/separate limitation loss (SLL)/overall domestic loss (ODL) and E&amp;P/Tax pools</td>
<td>Determine proper financial statement treatment and refine, if necessary, using year-end data, assess exposures, configure provision software to account for impacts of planning, book entries, and create audit support</td>
<td>Current year compliance data collection starts, one-off disclosures need to be assessed, inventoried, software rollover and other customization to be completed; roll forward of attributes and true-up of provision balances</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Holding companies

- Every multinational must consider how to integrate acquisitions, how to dispose of existing business lines and how to structure joint ventures.

- **Take advantage of deferral**
  - Shift income to low-tax foreign jurisdictions
  - Avoid triggering Subpart F inclusions – Section 954(c)(6)?

- **Minimize foreign income taxes**
  - Shift income from high-tax foreign jurisdictions to low-tax foreign jurisdictions
  - Minimize local country taxes (e.g., credits, incentives, loss utilization)
  - Minimize foreign withholding taxes

- **Maximize foreign tax credits**
  - Use repatriation strategies that maximize credits for foreign taxes already paid
    - E.g., prepayment of royalties for expiring FTCs

- **Non-taxable basis returns**
Pre-transaction structure

<table>
<thead>
<tr>
<th>Pre-transaction structure</th>
<th>Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Parent Corporation (USP) holds various entities directly. Desires to make structure more efficient</td>
<td></td>
</tr>
<tr>
<td>Considers a holding company structure</td>
<td></td>
</tr>
<tr>
<td>In the above and subsequent structures, assume 25% of foreign partnership held by unrelated US corporation</td>
<td></td>
</tr>
</tbody>
</table>

Considerations

Why consider implementing a holding company?

Ways to achieve structure?

- Holding company may facilitate debt push down strategies, tax efficient repatriation, withholding tax savings and deferral
- Establishing a holding company can be accomplished by Section 351 transfers, Section 304 sales or tax-free reorganizations
### After restructure

#### Post-transaction structure

<table>
<thead>
<tr>
<th>Overview</th>
<th>USP implements holding company (HoldCo)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Considerations</td>
<td>Allows all foreign operations to be efficiently organized under a common foreign holding company</td>
</tr>
<tr>
<td></td>
<td>Attributes of the entities influence the alternative</td>
</tr>
<tr>
<td></td>
<td>Consider separate holding company for pass-through entities</td>
</tr>
<tr>
<td></td>
<td>Consider high tax versus low tax – ownership chain</td>
</tr>
<tr>
<td></td>
<td>Holding company structure allows cash movement among foreign operations while maintaining deferral (assuming no Subpart F)</td>
</tr>
<tr>
<td></td>
<td>Same country financing structures</td>
</tr>
<tr>
<td></td>
<td>Leveraging through disregarded entities (DREs)</td>
</tr>
<tr>
<td></td>
<td>Holding company structure facilitates tax efficient disposals of foreign businesses (e.g., check and sell)</td>
</tr>
</tbody>
</table>

![Diagram](chart.png)
IRC Section 351 alternative

► Subchapter C considerations

► Under Internal Revenue Code (IRC) Section 351(a), no gain or loss is recognized provided: (1) only stock is received in exchange for property, and (2) exchanging shareholder(s) are in control of the corporation immediately after the exchange.

► Control is defined in IRC Section 368.

► IRC Section 367(a)(1) may turn off non-recognition treatment. IRC Section 367(a)(1) treats certain outbound transfers (i.e., US to foreign) that would otherwise be tax-free under IRC Section 351, 354, 356, or 361 as taxable for purposes of recognizing gain.

► IRC Section 367 does not permit loss recognition.
IRC Section 351 alternative

► Subchapter C considerations
  ► Gain Recognition Agreement (GRA) under Reg. Section 1.367(a)-8 (not applicable to foreign to foreign transfers)
    ► Form 8838 (Consent to Extend the Time to Assess Tax Under IRC Section 367)
    ► Annual GRA Certification will be required Reg. Section 1.367(a)-(8)(g)
  ► IRC Section 367(d) applies to outbound transfer of intangibles
  ► Outbound transfer of the disregarded entity (DRE)
    ► Dual consolidated loss (DCL) considerations
    ► Branch loss recapture – Section 367
    ► Debt transfers – Section 357(c), “Springing Liabilities,” etc.
  ► Consider IRC Section 362(e)(2)(C) election – when there is built-in loss property transferred in an IRC Section 351 transfer an election can be made to reduce transferor’s stock basis instead of Acquiring’s asset basis to the fair market value (FMV) of the property transferred
IRC Section 362(e)(2)(C) example

Facts

Corporation A

Corporation X

IRC Section 351 transfer of below assets from Corporation A to Corporation X in exchange for 1 X share

A transfers:
- Asset 1 – basis $90, FMV $60
- Asset 2 – basis $110, FMV $120

1. Without consideration of IRC Section 362(e)(2):
   - X's aggregate asset basis = $200 (90+110)
   - X's aggregate asset value = $180 (60+120)
   - The aggregate basis exceeds aggregate value of assets received in the transfer by $20

2. A's built-in loss is $20 ($200-$180)

3. Only Asset 1 is a loss duplication property since its basis exceeds its value

4. Result without a IRC Section 362(e)(2)(C) election
   - Under IRC Section 362(a) – X's basis in Asset 1 basis is $70 ($90 - $20 built-in loss)
   - Asset 2 basis is $110
   - A has $200 basis in the X stock

5. Result with a IRC Section 362(e)(2)(C) election
   - A has $180 basis ($200 - $20 built-in loss) basis in the X stock
   - X's basis in Asset 1 is $90 and in Asset 2 is $110
IRC Section 351 alternative

- Attribute, reporting and provision considerations
  - Non-controlled Section 902 corporation (10/50 company) and controlled foreign corporation (CFC)
    - Stock basis carries over to Foreign HoldCo stock under IRC Section 351
    - Attributes, i.e., E&P and Tax pools remain with the original corporation – consider the effect it may have on future repatriation due to the dividend coming up through the new HoldCo versus directly to the US
  - Monitor GRA-triggering events
  - Form 926 (Return by US Transferors of Property to a Foreign Corporation) and related IRC Section 6038B statements if GRA not required
    - Transfers in excess of $100,000
    - Including FMV and basis, or property transferred
    - Penalties for missing Form 926/6038B statement filings
IRC Section 351 alternative

- Attribute, reporting and provision considerations
  - Non-controlled Section 902 corporation (10/50 company) and CFC
    - Statements required under Treas. Reg. 1.351(a) and (b)
    - Including FMV and basis, or property transferred
    - Statements required under Treas. Reg. 1.367(b)-1(c)
  - Tax accounting
    - Impact of tax accounting on intercompany tax planning transactions
    - Deferred tax accounting for outside basis differences and impacts on global planning strategy
IRC Section 351 alternative

**Attribute, reporting and provision considerations**

**DREs**

- Asset inside basis carries over to Foreign HoldCo stock under IRC Section 351
- Form 926 and related IRC Section 6038B statements
  - Including FMV and basis, or property transferred
- Statements required under Treas. Reg. 1.351(a) and (b)
  - Including FMV and basis, or property transferred
- Review the type of assets being transferred to determine the effect of Section 367
  - Used in the active conduct of a trade or business
  - Tainted assets, for example – inventory, refer to IRC Section 1221(a)(1) or Copyrights, refer to IRC Section 1221(a)(3)
  - Intangible property may be taxable under IRC Section 367(d) and subject to certain reporting requirements
IRC Section 351 alternative

Attribute, reporting and provision considerations

DREs

- Consider – foreign branch loss recapture rules, dual consolidated loss recapture rules and overall foreign loss recapture
- Termination event for IRC Section 987
- Review intra-company assets and liabilities
  - Section 988 considerations
  - Springing assets and liabilities to life
- Two Forms 8858 required
- Taxes get allocated under Reg. Section 1.901-2(f)(4)(ii)

Tax accounting

- Impact of tax accounting on intercompany tax planning transactions
- Deferred tax accounting for outside basis differences and impacts on global planning strategy
Tax allocation under Reg. Section 1.901-2(f)(4)(ii)

Regulations
- Final Reg. § 1.901-2(f)(4), which applies to foreign taxes paid or accrued in taxable years beginning after 14 February 2012, provides:
  - If there is a change in the ownership of a disregarded entity (DE) during the DE’s foreign taxable year and such change does not result in a closing of the DE’s foreign taxable year, foreign tax paid or accrued with respect to such foreign taxable year is allocated between the transferor and the transferee.
  - The allocation is made based on the respective portions of the taxable income of the DE (as determined under foreign law) for the foreign taxable year that are attributable to the period of ownership of the transferor and the transferee during the foreign taxable year.

Facts
US, CFC2 and DE1 have a 31 December year-end for US federal income tax purposes. CFC2 and DE1 have a 31 December year-end for Country X tax and statutory purposes. On 30 June 2014, US forms CFC2 and contributes the assets of DE1 to CFC2.

1. DE1 – country X taxes in 2014 year of the transfer of 100 functional currency (FC) and taxable income of 300 FC
   - 1/1 – 6/30 – DE under US – taxable income of 149 FC and IRC Section 901 taxes of 50 FC ((149 TI/300 TI) * 100 taxes)
   - 7/1 – 12/31 – DE under CFC2 – E&P of 151 FC and IRC 902 taxes of 50 FC ((151/300 TI) * 100 taxes)
IRC Section 351 alternative

► Attribute, reporting and provision considerations
  ► Partnerships
    ► Partnership basis carries over to Foreign HoldCo stock under IRC Section 351
    ► Technical termination of the partnership under IRC Section 708(b)(1)(B)
    ► IRC Section 987 considerations
    ► Allocation of partnership income and taxes based on holding period
    ► Two Forms 8865 – Category 1 filings, consider need for Category 4 filing and potential multiple Category 3 filings (Return of US Persons With Respect to Certain Foreign Partnerships) and Form 1065 (US Return of Partnership Income) – required to make elections
IRC Section 351 alternative

► Attribute, reporting and provision considerations
  ► Partnerships
    ► Tax accounting
      ► Impact of tax accounting on intercompany tax planning transactions
      ► Deferred tax accounting for outside basis differences and impacts on global planning strategy
IRC Section 304

Subchapter C considerations

Section 304(a)(1) applies to the sale of a corporation’s stock to another corporation, where both the acquiring corporation and the target corporation are under common control.

The fiction of Section 304 is as if the shares of the target corporation were contributed to the acquiring corporation in a Section 351 transaction, followed by the redemption of the deemed shares issued in such Section 351 transaction.

If the redemption does not qualify under Section 302, Section 301 will apply.

Section 304(b)(2) provides that the determination of the dividend amount is made as if the property were distributed by the acquiring corporation to the extent of its E&P and then by the target corporation to the extent of its E&P.

GRA under Section 367 required to avoid gain.

Section 304 does not apply to sales of DREs or partnership interests.
IRC Section 304

Attributes, reporting and provision considerations

CFC

- Section 304(a)(1) applies
  - Treated as an IRC Section 351 of CFC1 stock to Foreign HoldCo, then
  - Redemption of Foreign HoldCo stock
- Dividend to the extent of E&P under IRC Section 301(c)(1)
  - First to Foreign HoldCo
  - Second to CFC1
IRC Section 304 alternative

Attributes, reporting and provision considerations

► CFC

► If proceeds are in excess of E&P of Acquiring and Target
  ► Return of Capital (ROC) under IRC Section 301(c)(2), then
  ► Capital gain or loss under IRC Section 301(c)(3)

► Form 5452 to report ROC distributions

► Tax accounting
  ► Determine period gain and current tax impacts to be recognized in income statement
  ► Accounting Principles Board (APB) 23 posture and dividends sourced out of E&P
Sale of 10/50 corporation

- Attribute, reporting and provision considerations
  - 10/50 corporation
    - Treated as a sale of stock
    - Foreign HoldCo gets stepped up basis in the stock
    - Any gain is passive source under IRC Section 954(c)(1)(A)
    - Any loss is passive source under IRC Section 954(c)(1)(B) and Treas. Reg. 1.865-2(a)
      - Treas. Reg. 1.865-2(a) provides that losses attributable to stock are allocated to the class of gross income with respect to which gain from a sale of such stock would give rise in the hands of the seller.
Sale of 10/50 corporation

Attribute, reporting and provision considerations

10/50 corporation

- Any loss is passive source under IRC Section 954(c)(1)(B) & Treas. Reg 1.865-2(a)
  - Dividend recapture exception – Treas. Reg. 1.865-2(b) establishes that if seller recognized a loss with respect to shares of stock, and it had included in income a dividend recapture amount with respect to such shares at any time during the 24 month period ending on the date on which seller recognized the loss with respect to stock, then, to the extent of the dividend recapture amount, the loss should be allocated to the category of gross income (i.e., general limitation or passive basket) to which the dividend recapture amount was assigned.

Tax accounting

- Deferred tax accounting for outside basis differences and impacts on global planning strategy
IRC Section 304

- Attributes, reporting and provision considerations
  - Partnership
    - Treated as a sale of partnership interest under IRC Section 1001
    - Termination under IRC Section 708(b)(1)(B)
    - Section 741 – character of gain versus Section 751 – hot assets
    - Section 754 elections
  - IRC Section 987 considerations
  - Allocation of partnership income and taxes
  - At least two Forms 8865 (Return of US Persons With Respect to Certain Foreign Partnerships) and Form 1065 (US Return of Partnership Income) – first year elections
  - Anti-churning issue
  - Tax accounting
    - Impact of tax accounting on intercompany tax planning transactions
Section 304 brother-sister transaction

**Pre-transaction**

- CFC1 transfers CFC2 to Foreign Sub HoldCo in exchange for a note payable (or cash)

**Overview**

- Section 304(a)(1) applies to the transfer of CFC2 to Foreign Sub HoldCo for a note
  - Treated as a Section 351 contribution of CFC2 stock to Foreign Sub HoldCo in exchange for Foreign Sub HoldCo shares; then
  - Redemption of the Foreign Sub HoldCo shares deemed issued in the previous step

**Anticipated results**

- CFC1 transfers CFC2 to Foreign Sub HoldCo in exchange for a note payable (or cash)
Section 304 brother-sister transaction

Pre-transaction

Overview

- CFC1 transfers CFC2 to Foreign Sub HoldCo in exchange for a note payable (or cash)

Anticipated results

- CFC1 recognizes a dividend under Section 301(c)(1) on deemed redemption of Foreign Sub HoldCo stock
  - Sourced first from the E&P of Foreign Sub HoldCo
  - If Foreign Sub HoldCo has inadequate E&P, dividend is then sourced from the E&P of CFC2
- To the extent that cash proceeds exceed the earnings and profits of Foreign Sub HoldCo and CFC2, the excess cash is treated as a return of capital and thus reduces the basis of the stock of Foreign Sub HoldCo under Section 301(c)(2)
- Distribution in excess of dividend and capital amount is treated as a capital gain under Section 301(c)(3)
Sale of DRE from CFC to Foreign Sub HoldCo

Pre-transaction and post-transaction

Overview

► Assume that CFC1 has historically owned a foreign entity that is disregarded for US tax purposes (DRE2)
► CFC1 sells DRE2 to Foreign HoldCo in exchange for a note payable (or cash)

Anticipated results

► Fully taxable transaction – Section 1001
► Foreign Sub HoldCo takes a purchase price/FMV basis in the DRE assets acquired
Sale of DRE from CFC to Foreign Sub HoldCo

- Attributes, reporting and provision considerations
  - DRE
    - Taxable transaction under IRC Section 1001
    - Source and basket of gain
    - Allocation of foreign taxes
    - Foreign HoldCo takes FMV in the assets of the DRE
    - IRC Section 367(d) does not apply
    - Anti-churning issue – contracts issue not as complicated as with partnerships
  - Section 987 consequences
    - Tax accounting – deferred tax accounting for outside basis differences and impacts on global planning strategy
Pre-transaction and post-transaction

Overview
- USP transfers CFC1 to Foreign HoldCo in exchange for a note payable (or cash)
- CFC1 elects to be disregarded for US tax purposes

Anticipated results
- Same legal transaction as Parent/Subsidiary Section 304, except the election to disregard CFC1 converts tax treatment to an all cash Section 368(a)(1)(D) reorganization (see Rev. Rul. 67-274)
- Considered a reorganization and attributes carry over as long as CFC1 is solvent
- USP may recognize gain in its CFC1 stock to the extent of the boot
- Boot treated as a dividend pursuant to Section 356(a)(2)
- No GRA required
IRC Section 368(a)(1)(D) alternative

- Subchapter C considerations

IRC Section 368(a)(1)(D) – is a tax-free reorganization whereby a corporation transfers all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under § 354, 355, or 356.
IRC Section 368(a)(1)(D) alternative

- Solvency of entity liquidating
- Statements required under Treas. Reg. 1.368-3(a) and (b)
  - Including FMV and adjusted basis of the CFC
- Treas. Reg. 1.367(b)-1(c) (IRC Section 367 Notice)
  - Including any amount required to be taken into account as income or loss or as an adjustment to basis or E&P
- Timing of liquidation / check-the-box (CTB) election for CFC
  - Before drop potentially an all E&P pick up under IRC Section 332
  - After drop, E&P and Tax pools carry over to Foreign
IRC Section 368(a)(1)(D) alternative

- Attribute, reporting and provision considerations
  - E&P and Tax pools combined with Foreign HoldCo
    - Hovering deficit
  - Form 5471 and Form 8858
    - Splitting of E&P and taxes
  - Form 8832 (Entity Classification Election)
  - Form SS-4 (Application for Employer Identification Number)
  - Form 966 (Corporate Dissolution or Liquidation) – not required because not actual liquidation

- Tax accounting
  - Outside basis and APB 23 posture
  - Transactions with boot
  - Risks if transaction is re-characterized as Section 351 transfer with Section 332 liquidation
Uncheck-the-box on DRE1

Pre-transaction

Post-transaction

Deemed asset transfer
Uncheck-the-box on DRE1

Subchapter C considerations

- Generally treated as IRC Section 351 transfer
- IRC Section 367(a)(1) may turn off non-recognition treatment, for purposes of recognizing gain, but not loss, for certain asset transfers:
  - Account receivable, installment obligations, etc. not previously included in taxable income
  - Branch loss recapture
  - Certain foreign currency or foreign currency denominated receivables, etc.
- IRC Section 367(d) applies to outbound transfer of intangibles
- Dual consolidated loss (DCL) considerations
- Debt assumption – Section 357(c), springing liabilities, etc.
- If DRE owns stock – GRA under Reg. Section 1.367(a)-8
  - Form 8838 consent to GRA
  - Annual GRA Certification will be required Reg. Section 1.367(a)-(8)(g)
Attributes, reporting and provision considerations

- Assuming no gain is recognized, asset basis carries over to new foreign company stock under IRC Section 351
- Form 926 and related IRC Section 6038B statements, if no GRA required.
  - Form 926 – report transfer of property to a foreign corporation
  - Transfers in excess of $100,000
  - Including FMV and basis, or property transferred
- Statements required under Treas. Reg. 1.351(a) and (b)
  - Including FMV and basis, or property transferred
Uncheck-the-box on DRE1

- Attributes and reporting considerations
  - Termination of IRC Section 987 equity and basis pools
  - Review intra-company assets and liabilities
    - IRC Section 988 considerations
    - Springing assets and liabilities into life
  - One Forms 8858 and one Form 5471
  - Taxes don’t get allocated under Reg. Section 1.901-2(f)(4)(ii)
  - Tax accounting
    - Determine change to outside basis
    - Determine period of recognized changes in basis for tax accounting purposes
Contacts

**Michael Medley**
Ernst & Young LLP | Iselin, NJ
+1 732 516 4462
michael.medley@ey.com

**Tina Minozzi**
Ernst & Young LLP | New York, NY
+1 212 773 1348
tina.minozzi@ey.com

**James Sauer**
Ernst & Young LLP | New York, NY
+1 212 773 1161
james.sauer@ey.com

**Sue Lippe**
Ernst & Young LLP | Chicago, IL
+1 312 879 4254
sue.lippe@ey.com