US Tax Update

August 27 & 28, 2014
São Paulo & Rio de Janeiro, Brazil
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Agenda

► US Legislative Update
► OECD BEPS Update
► Transfer Pricing Update
► US Inbound Investment Update
Your presenters

► Jay Camillo, Americas Markets Leader, Transfer Pricing and Economics
► Peter Griffin, Americas Transfer Pricing Leader
► Jeffrey Michalak, Americas International Tax Services Leader
► Simon Moore, Americas International Tax Services Chief Operating Officer
► Stephen O’Neil, Americas Markets Leader, International Tax Services
US economic snapshot

**Economic growth**
- Q2 2014 GDP rose 4%*
- Rebound from a 2.1%* decline in Q1
- Exceeded economists’ expectations

**Job market**
- Unemployment at 6.2% (July 2014)
- Down from 7.3% in July 2013
- Employers adding jobs, but concerns remain about low wages

**Housing market**
- Home prices increasing more slowly
- Existing home sales up 2.6% (June 2014)**
- Inventory of foreclosures down**

*Annualized GDP numbers
**Compared to last year
Long-term: Spending grows, revenue remains flat

% of GDP

- Discretionary and other mandatory spending
- Net Interest
- Medicare and Medicaid
- Social Security Outlays
- Revenue

Source: Updated Budget Projections: Fiscal Years 2013 to 2023, CBO (Congressional Budget Office), and Ernst & Young LLP calculations.
## 2014 elections: Senate

Seats up for re-election: **21 Democratic, 15 Republican**

<table>
<thead>
<tr>
<th>Democrats</th>
<th>Republicans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mark Begich (AK)</td>
<td>Lamar Alexander (TN)</td>
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<tr>
<td>Cory Booker (NJ)</td>
<td>Saxby Chambliss (GA) *</td>
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<tr>
<td>Chris Coons (DE)</td>
<td>Tom Coburn (OK) *</td>
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<tr>
<td>Richard Durbin (IL)</td>
<td>Thad Cochran (MS)</td>
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<td>Al Franken (MN)</td>
<td>Susan Collins (ME)</td>
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<td>Kay Hagan (NC)</td>
<td>John Cornyn (TX)</td>
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<td>Tom Harkin (IA) *</td>
<td>Mike Enzi (WY)</td>
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<td>Tim Johnson (SD) *</td>
<td>Lindsey Graham (SC)</td>
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<td>Mary Landrieu (LA)</td>
<td>James Inhofe (OK)</td>
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<td>Carl Levin (MI) *</td>
<td>Mike Johanns (NE) *</td>
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<tr>
<td></td>
<td>Mitch McConnell (KY)</td>
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<tr>
<td>* Not running for reelection</td>
<td>Jim Risch (ID)</td>
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<td></td>
<td>Pat Roberts (KS)</td>
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<td></td>
<td>Tim Scott (SC)</td>
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<td>Jeff Sessions (AL)</td>
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</table>
2014 elections: House

- Bottom line: House to largely stay the same
- 96% of House races uncompetitive
- Republicans likely to retain control
- Several prominent members retiring, including committee chairmen
  - Rep. Dave Camp (R-MI) – Ways and Means Chairman
  - Rep. Buck McKeon (R-CA) – Armed Services Chairman
  - Rep. Doc Hastings (R-WA) – Natural Resources Chairman
  - Rep. John Dingell (D-MI) – House member since Dec. 13, 1955 (longest serving in history)
  - Rep. George Miller (D-CA) – Education & Workforce ranking Democrat/Member since 1975
Inversions attracting attention in Congress

- Inversions by large companies have spurred calls for tax reform, anti-inversion proposals taking various approaches:
  - Change ownership test to require more than 50% of stock be owned by those who were not stockholders of original domestic corporation.
  - Provide that an inversion transaction will occur if management and control of the merged company remains in US, 25% of its employees, income, or assets are located in US.
  - Earnings stripping:
    - Repeal debt-to-equity safe harbor under Section 163(j).
    - Reduce permitted net interest expense to no more than 25% of the entity’s adjusted taxable income.
    - Amend Section 956 to provide that stock and debt obligations of non-CFC (Controlled Foreign Corporation) foreign affiliates held by CFCs trigger current US income tax to US shareholders.
  - Prohibit award of federal contracts to inverted corporations.
Treasury studying authority to act on inversions independent of Congress

► Treasury considering executive actions to curb inversions
► President Obama met with Treasury Secretary Jack Lew, others August 19
► Treasury Department Aug. 5:
  ► “Treasury is reviewing a broad range of authorities for possible administrative actions that could limit the ability of companies to engage in inversions.”
  ► Considering “approaches that could meaningfully reduce the tax benefits after inversions take place, to at least provide a partial fix.”
► Secretary Lew said in mid-July the Administration cannot address inversions through executive action
OECD BEPS Update
Overview of OECD BEPS project

► The OECD’s Action Plan on Addressing Base Erosion and Profit Shifting (BEPS) is aimed at government concern about potential for multinational companies (MNCs) to reduce their tax liabilities through shifting of income to no- or low-tax countries

► Driven by MNC tax issues that have been in the headlines around the world

► G8 and G20 governments have endorsed OECD’s work on BEPS and have committed to individual country action

► Major non-OECD countries, including China and India, are actively participating in BEPS project

► Responsive changes over the next several years will differ across countries in specifics and in timing, reflecting each country’s particular circumstances

► Many countries are taking action already, without waiting for OECD recommendations

► The OECD BEPS agenda is ambitious in both scope and timing, the issues are complex, but there is a real sense of political imperative
2014 OECD activity

- Since start of 2014, OECD has issued discussion drafts on 4 Actions:
  - Action 1: Digital economy
  - Action 2: Hybrid mismatch arrangements
  - Action 6: Treaty abuse
  - Action 13: Transfer pricing documentation and country-by-country (CbC) reporting
- OECD has informally announced modifications to original discussion draft containing CbC reporting template and transfer pricing master file
- OECD has continued work on Action 8: Transfer pricing for intangibles
- OECD also has worked on 2 other Actions without any public releases:
  - Action 5: Harmful tax practices
  - Action 15: Multilateral instrument
- Output with respect to all seven of these Actions to be released publicly in connection with September G20 Finance Ministers meeting
  - OECD work will continue in these areas into 2015, together with work on the 2015 Actions
OECD discussion draft on CbC reporting

- Increased information reporting to tax authorities is highest priority
  BEPS response for OECD and many countries
- OECD is developing common template requiring country-based
  information on income, taxes and economic activity with respect to
  each country where MNC has entity to be provided to all such
  countries
- Information to be required for each country is expected to include:
  - Revenue – related party and third party
  - Earnings before income tax
  - Cash taxes paid and current tax accrual
  - Capital and accumulated earnings
  - Number of employees
  - Tangible assets
Changes in international tax environment
Evolution not revolution

► Continued focus on substance and alignment with business
► Greater complexity in transfer pricing and more risk of deviation from arm’s length principle
► Increased transparency and sharing of information across jurisdictions
► More, and more complex, controversy
► More pressure on dispute resolution mechanisms
► Greater emphasis on early, proactive engagement with tax authorities to gain certainty and avoid/resolve disputes
Transfer Pricing Agenda

- Intangibles planning
- Transfer pricing risk assessment
- Transfer pricing audit roadmap
- Managing the audit process
Objectives of intangibles planning

► Alignment of intangibles with business needs:
  ► Manufacturing outside the US:
    ► For non-US markets
    ► For US markets
  ► Regional and local marketing organizations

► Bear the cost of intangible development where the intangibles will be exploited:
  ► High-growth emerging markets

► Supply chain restructurings:
  ► Efficiencies and cost reduction
  ► Changes in product flows
  ► Move to outsourcing

► Acquisitions and dispositions
Tax considerations in IP planning

US considerations:
► Valuation of IP
► Form of intangible transaction:
  ► Sale, cost-sharing, license
► Start-up vs. mature company
► Transfers from the US:
  ► Section 367(a) and (d)
  ► US transfer pricing
  ► US GAAP profile
► US tax reform proposals:
  ► Camp proposal
  ► Obama budget proposal
  ► Use of IP offshore for US markets

Non-US considerations:
► Valuation of IP
► Form of intangible transaction:
  ► Sale, cost-sharing, license
► IP company considerations:
  ► Amortization
  ► Treaty network
  ► IP protection
► Local country considerations:
  ► Withholding tax
  ► Deductibility of payments

OECD proposals:
► BEPS
► Intangibles draft
Transfer pricing risk assessment
Latest developments

- Organisation for Economic Co-operation and Development (OECD)
  - UN Transfer Pricing Manual (2013)
  - G8 Communiqué Lough Erne (Ireland) meeting June 2013 (tax and risk assessment)
  - Base erosion profit shifting (BEPS) report (2013)
    - Transfer pricing (TP) Documentation White Paper
  - Country-by-country reporting (2014)
  - Single global standard for automatic exchange of information (EOI) (2014)
- US/IRS: re-issuance of Internal Revenue Service (IRS) transfer pricing audit roadmap (2014)
What does this mean?

▲ TP documentation transforms from compliance component into full-out risk assessment tool:
  ▶ Quality of TP documentation is an exposure item
  ▶ Controversy considerations to be made while establishing TP documentation

▲ Emphasis on cooperation and pre-audit consultations:
  ▶ PowerPoint TP documentation for pre-audit consultations?
  ▶ “Horizontal monitoring” (enhanced relationship) – like approaches?
  ▶ Bilateral or multilateral pre-audit consultations?
What does increased scrutiny and coordination mean for multinational enterprises (MNE)?

- Strategic entering into and use of advance pricing agreements (APA):
  - Exchange of unilateral APAs part of (EU) Code of Conduct
  - Proactive taxpayer disclosure of (unilateral or bilateral) APAs
  - Proactive taxpayer disclosure of rulings

- Proactive use and management of simultaneous/joint audits:
  - Establishing code of conduct/process guideline
  - Multi-jurisdiction management resources needed, or established audit process
Transfer pricing audit roadmap

Overview

► Published February 14, 2014, by the IRS, provides best practices and reference materials for Large Business and International (LB&I) employees with respect to the administration of TP audits

► Organized around a basic 24-month (aspirational) audit timeline; three phases:
  ► Planning
  ► Execution
  ► Resolution

► Encourages cross-functional teaming within LB&I, with heavy involvement of transfer pricing specialists as well as significant taxpayer involvement
Conclusion

► Stay informed
► Stay engaged
► Remain connected
► Remain alert
► Be proactive
Inbound focus: Proposed US international tax legislation

- “Insourcing” tax credit included in President Obama’s FY2015 budget
- Bring Jobs Home Act introduced in Congress last year
- Tax incentives for “insourcing” (H.R. 5542/S. 2884)
  - Would grant businesses a tax credit of up to 20% of insourcing expenses
  - Would apply to companies that eliminate a business unit outside the US and transfer it into the US
  - To claim the tax credit, the taxpayer would have to increase employment of full-time employees in the US
Levin discussion draft could affect inbound investors

House Ways and Means Committee member Sander Levin (D-MI) released the *Stop Corporate Earnings Stripping Act of 2014* as a discussion draft 31 July

- Would repeal the debt-to-equity safe harbor under Section 163(j) and reduce the permitted net interest expense to no more than 25% of an entity’s adjusted taxable income
- Would amend Section 956 to require that stock and debt obligations of foreign affiliates that are not controlled foreign corporations (CFCs) but are held by CFCs trigger current US income tax to US shareholders
- Legislation not limited to inverted companies
- Levin seeking stakeholder feedback through 5 September
- Senate Finance Committee member Charles Schumer (D-NY) also preparing legislation to limit interest expense deductions, but only for inverted companies
Inbound focus: “Managed and controlled” test

“Managed and controlled test” for non-US corporations

► Would treat certain foreign corporations that meet either a public trading test or a gross assets test and that are considered to be managed and controlled in the US as US corporations

► Would apply to a foreign corporation if either:
  ► The stock is regularly traded on an established securities market; or
  ► The aggregate gross assets of the foreign corporation at any time during the tax year or any preceding tax year is $50 million or more (exception for certain CFCs)
  ► Scored to raise $5.4 billion over 10 years* and apply to tax years beginning on or after the date which is two years after the date of enactment

► Has been included in several pieces of legislation:
  ► The Stop Tax Haven Abuse Act (S. 1533) (September 2013)
  ► The International Tax Competitiveness Act of 2013 (H.R. 155) (April 2013)
  ► The Corporate Tax Fairness Act (S. 250) (February 2013)
  ► Also included on list of “top tax loopholes” (Sen. Patty Murray (D-WA))

*JCT (Joint Committee on Taxation scoring as originally introduced in 2009)
Economic outlook: White House mid-session review (July 11, 2014)

- Short-term improvement in budget outlook but worsening long-term picture

- 2014 deficit projected to be $583 billion
  - $66 billion lower than projected in March
  (deficit was $366 billion through the end of June)

- 2015-2024 deficit projected to be $5.5 trillion
  - Nearly $600 billion higher than projected in March
  - Projected real GDP growth in the long run is below the historical average due to decline in the growth of the labor force as the baby-boom generation retires
Lower deficits projected for this year and next
- FY2013 = $680 billion
- FY2014 = $492 billion
- FY2015 = $469 billion

Deficits to increase beginning in FY2016
- Higher spending, slower growth from aging population
- $1 trillion deficit projected for 2022, 2023, 2024
- 2015-2024 total deficit: $7.6 trillion

Source: CBO “Updated Budget Projections: 2014 to 2024,” April 2014
### Political configuration in 113th Congress

<table>
<thead>
<tr>
<th>House</th>
<th>Senate</th>
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</thead>
<tbody>
<tr>
<td>234 Republicans</td>
<td>55 Democrats</td>
</tr>
<tr>
<td>199 Democrats</td>
<td>45 Republicans</td>
</tr>
</tbody>
</table>

(2 vacancies: New Jersey, North Carolina)

**House**
- Speaker: John Boehner (R-OH)
- Majority Leader: Kevin McCarthy (R-CA)
- Majority Whip: Rep. Steve Scalise (R-LA)

**Senate**
- Majority Leader: Harry Reid (D-NV)
- Majority Whip: Dick Durbin (D-IL)
- Democratic Conference Committee Vice Chair, Policy Committee Chair: Chuck Schumer (D-NY)

**Democratic leader:** Nancy Pelosi (D-CA)
- Democratic Whip: Steny Hoyer (D-MD)
- Asst. Democratic Leader: James Clyburn (D-SC)

**Republican leader:** Mitch McConnell (R-KY)
- Republican Whip: John Cornyn (R-TX)
- Republican Conference Chair: John Thune (R-SD)
Tax extenders

► 55 business, individual provisions expired Dec. 31, 2013

► **Senate approach**: two-year extension (2014, 2015) of provisions that expired at the end of 2013
  ► Senate floor consideration halted over amendment disagreement
  ► GOP senators demanded vote to delay medical device excise tax

► **House approach**: Chairman Camp wants budget baseline to reflect widely supported tax policies
  ► Would make it easier to advance tax reform legislation
  ► Ways and Means, full House processing standalone bills to make permanent individual tax policies

► **Expected outcome**: Some lawmakers expect that a two-year extenders package will be approved late in 2014
## Select tax extender provisions

<table>
<thead>
<tr>
<th>Provision, 2-year extension</th>
<th>10-year cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>R&amp;D credit</td>
<td>$16 billion</td>
</tr>
<tr>
<td>Active financing exception</td>
<td>$10 billion</td>
</tr>
<tr>
<td>15-year straight-line cost recovery for leasehold, retail, restaurant improvements</td>
<td>$5 billion</td>
</tr>
<tr>
<td>Bonus depreciation</td>
<td>$3 billion</td>
</tr>
<tr>
<td>CFC look-through rule</td>
<td>$2.5 billion</td>
</tr>
<tr>
<td>New markets tax credit</td>
<td>$2 billion</td>
</tr>
<tr>
<td>Deduction for State, local sales taxes</td>
<td>$6.5 billion</td>
</tr>
<tr>
<td>Tax-free IRA distributions to charity</td>
<td>$1.8 billion</td>
</tr>
<tr>
<td>Incentives for biodiesel, renewable diesel</td>
<td>$2.5 billion</td>
</tr>
<tr>
<td>Excise tax credits for alternative fuels, mixtures</td>
<td>$1 billion</td>
</tr>
</tbody>
</table>

Source: JCX-51-14
Congress passes measure extending highway funding through May 2015

- Congress July 31 agreed to the *Highway and Transportation Funding Act of 2014* (H.R. 5021), to extend highway funding through May 31, 2015.
- Lawmakers will debate a long-term approach between now and then.
- Highway Trust Fund faces funding shortfall because fuel taxes have not been increased since 1993: gas tax of 18.4 cents/gallon, diesel tax of 24.4 cents/gallon.
- Fuel economy has improved and the taxes were not indexed for inflation.
- The short-term measure includes the following revenue provisions:

<table>
<thead>
<tr>
<th><em>Highway and Transportation Funding Act of 2014</em> provision</th>
<th>10-year revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension smoothing</td>
<td>$6.4 billion</td>
</tr>
<tr>
<td>Extension of customs user fees/Merchandise processing fee</td>
<td>$3.5 billion</td>
</tr>
<tr>
<td>Leaking Underground Storage Tank Trust Fund transfer</td>
<td>No effect</td>
</tr>
</tbody>
</table>
Long-term highway funding options

- **Tax reform revenue**
  - President Obama’s FY2015 Budget: $150 billion to HTF (Highway Trust Fund) temporary revenue from transition to tax reform
  - Chairman Camp’s tax reform draft: $126.5 billion to HTF from deemed repatriation of foreign earnings

- **Standalone repatriation**
  - Sens. Paul, Reid pushing for repatriation outside of tax reform
  - Sens. Hatch, Wyden resistant, want to save revenue for tax reform

- Insufficient political will seen for increasing gas tax
Tax leaders push ahead but tax reform prospects uncertain

- Congressional tax committee chairmen pushing to mark up reform bills this fall
  - May be tied to legislation to raise debt limit or considered as stand-alone bill

- Significant disagreements persist over:
  - Revenue
  - Corporate reform only or individual/corporate reform together?
  - Corporate tax rate: how low?
### High-level summary of key tax reform proposals

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Highlights</th>
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<tbody>
<tr>
<td>President Obama’s <em>Framework for Business Tax Reform</em> (February 2012) and July 2013 speech</td>
<td>28% corporate tax rate. Retains worldwide tax system. Imposes minimum tax on overseas profits. Spends some of the revenue from tax reform on jobs, infrastructure.</td>
</tr>
<tr>
<td>Chairman Camp’s financial products tax reform draft (January 2013)</td>
<td>Requires derivatives to be marked to market unless they qualify as hedges for tax purposes. Expands range of transactions to which the mark-to-market requirements could apply.</td>
</tr>
<tr>
<td>Chairman Camp’s international tax reform draft (October 2011)</td>
<td>25% corporate tax rate. Moves to territorial system with dividends received deduction. Three options to address tax base erosion, income shifting.</td>
</tr>
<tr>
<td>Chairman Baucus’ international tax reform discussion draft (November 2013)</td>
<td>No specific rate reduction included but expectation is below 30% corporate tax rate. Limits interest deductibility. Repeals tax deferral of foreign earnings, retains FTC (Foreign Tax Credit) system with partial DRDs (Dividends Received Deduction).</td>
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<tr>
<td>Action Plan</td>
<td>Date Range</td>
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<td>---------------------------------------------------------------------------</td>
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<tr>
<td>1) Tax challenges of digital economy</td>
<td>September 2014</td>
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<td>2) Hybrid mismatch arrangements</td>
<td>September 2014</td>
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<tr>
<td>3) Controlled foreign corporation (CFC) rules</td>
<td>September 2015</td>
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<tr>
<td>4) Deductibility of interest and other financial payments</td>
<td>September/December 2015</td>
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<tr>
<td>5) Harmful tax practices</td>
<td>September 2014/September 2015/December 2015</td>
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<tr>
<td>6) Treaty abuse</td>
<td>September 2014</td>
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<tr>
<td>7) Artificial avoidance of permanent establishment status</td>
<td>September 2015</td>
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<tr>
<td>8) Transfer pricing for intangibles</td>
<td>September 2014/September 2015</td>
</tr>
<tr>
<td>9) Transfer pricing for risks and capital</td>
<td>September 2015</td>
</tr>
<tr>
<td>10) Transfer pricing for other high-risk transactions</td>
<td>September 2015</td>
</tr>
<tr>
<td>11) Development of data on BEPS and actions addressing it</td>
<td>September 2015</td>
</tr>
<tr>
<td>12) Disclosure of aggressive tax planning arrangements</td>
<td>September 2015</td>
</tr>
<tr>
<td>13) Transfer pricing documentation</td>
<td>September 2014</td>
</tr>
<tr>
<td>14) Effectiveness of treaty dispute resolution mechanisms</td>
<td>September 2015</td>
</tr>
<tr>
<td>15) Development of a multilateral instrument for amending bilateral tax treaties</td>
<td>September 2014/December 2015</td>
</tr>
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</table>
Country activity with respect to preventing treaty abuse

Country activity since start of 2014 aimed at preventing treaty abuse has included:

- **Mexico** – 2014 tax reform included new requirements for eligibility for treaty benefits
- **Russia** – Tax reform debate includes discussion of requiring disclosure of information on the ultimate beneficiary of a company
- **Vietnam** – New circular issued to provide that tax treaty benefits will be denied if a main purpose of transaction or arrangement is tax abusive and/or if treaty benefit claimant is not true beneficial owner
- **Canada** – Consultation initiated on anti-treaty shopping rules and domestic “main purpose” test approach
- **Russia** – Ministry of Finance letter to tax authorities calling for denial of beneficial ownership status where transaction or series of transactions results in all or nearly all income being paid to party not eligible for treaty benefits
Country activity with respect to hybrid mismatch arrangements

Country activity since start of 2014 aimed at addressing hybrid mismatch arrangements has included:

- **Mexico** – 2014 tax reform included rules targeting interest, royalty and technical services payments to related parties that are not taxed
- **France** – 2014 finance bill included rules denying deductions for interest payments to related parties that are subject to low tax
- **Austria** – 2014 tax reform included provision imposing subject-to-tax test with respect to deduction for interest and royalties paid to related parties
- **Netherlands** – State Secretary announced support for European Commission efforts to address tax mismatches arising from hybrid loans but opposed EC proposal for incorporating GAAR (general anti-abuse rule) in parent-subsidiary directive
- **Spain** – draft bill to include anti hybrid rules on inbound and outbound transactions
- **Australia** – draft bill to deny non portfolio dividend exemption on instruments treated as “debt” under Australian debt / equity rules
- **Japan** – Tax System Study Council discussed proposal to exclude from participation exemption dividends that are deductible in subsidiary’s country
BEPS and US tax reform
Treasury has lead role in OECD BEPS project and is taking strong stand on development of several key action items, including:

- CbC reporting template
- Addressing treaty abuse
- Digital economy
- Transfer pricing for intangibles

Administration’s Budget includes several proposals with BEPS overtones, including:

- Denial of deductions for “excessive” interest expense
- Deferral of interest deductions deemed to relate to deferred income
- New categories of Subpart F income for digital goods and services and for excess returns on transferred intangibles
- Imposition of minimum tax on foreign earnings
- Restrictions on use of hybrids
Congress and BEPS

► Addressing BEPS has also become element of Congressional efforts on fundamental international tax reform

► House Ways and Means Committee Chairman Camp’s comprehensive tax reform discussion draft contains several BEPS-related proposals as part of international tax reform, including:
  ► Broad new category of Subpart F income for deemed intangible income
  ► Limitation on treaty benefits
  ► Restrictions on interest expense deductions
  ► Tightening of Section 163(j) “earnings stripping” limits

► Former Senate Finance Committee Chairman Baucus’ international tax reform staff discussion draft also contained BEPS-related proposals, including:
  ► Broad expansions of Subpart F income
  ► Restrictions on interest expense deductions
  ► Denial of deductions with respect to hybrids
OECD discussion draft on preventing treaty abuse

- Proposal for multi-prong approach
- Robust US-style limitation on benefits provision
  - Series of mechanical tests
  - Discretionary relief as catchall
- **Plus** UK-style main purpose test
  - Treaty benefit denied if reasonable to conclude that “obtaining that benefit was one of the main purposes of any arrangement or transaction that resulted directly or indirectly in that benefit”
  - Exception if granting benefit would be in accordance with “object and purpose” of relevant provisions of treaty
- **Plus** specific treaty anti-abuse rules to address particular treaty provisions
- **Plus** new preamble language on purpose of treaties
OECD discussion drafts on hybrid mismatch arrangements

- Proposal for changes to domestic law to address situations involving deduction in one country and no inclusion in other country or deductions in both countries
  - Also proposed coordination rules to be included in treaties
- Three categories of hybrids addressed:
  - Hybrid financial instruments, including hybrid transfers
  - Hybrid entity payments
  - Reverse hybrids and imported mismatches
- Recommended changes to domestic law
  - No dividend exemption for deductible payments and limit on withholding tax credits
  - Tax filing and information requirements
- Recommended “linking rule” approach
  - Proposed *primary* response generally is denial of deduction in payer or investor country
  - Proposed *defensive* rule generally is income inclusion in payee country
OECD discussion draft on tax challenges of digital economy

- Discussion draft largely devoted to review of development of digital economy and key features of new business models
- Focus on potential BEPS strategies in the digital economy and how these can be addressed in other Actions, including:
  - Hybrid mismatch arrangements
  - Preventing treaty abuse
  - Transfer pricing, including with respect to intangibles
  - Strengthening controlled foreign corporation rules
  - Limiting interest deductions
  - Countering harmful tax practices
  - Preventing artificial avoidance of permanent establishment status
- Also identification of broader tax issues arising in connection with digital economy, with brief summary of potential options for future evaluation
OECD revised discussion draft on transfer pricing for intangibles

- Guidance on location savings and other local market characteristics, assembled workforce, and group synergies
- Broad definition of intangibles
  - Rejection of legal and accounting definitions
- Entitlement to intangible return based not on ownership of intangible but rather on contribution to intangible value
  - Performance/control of important functions related to development, enhancement, maintenance and protection of intangibles
  - Provision of funding and other assets
  - Bearing and exercise of control over intangible risks
- Identification/characterization of intangibles transactions
- Guidance on transfer pricing methods and comparability
- Multiple illustrative examples
### Trends in IP ownership

<table>
<thead>
<tr>
<th>IP ownership</th>
<th>Illustrative structures</th>
<th>Industry preferences</th>
<th>Approximate effective tax rate</th>
<th>Approximate usage</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. “Offshore”</td>
<td>Bermuda, Cayman, non-resident Irish company, partnership structures (Dutch CV, UK LLP, etc.), Malta, Dubai</td>
<td>Life sciences, chemical, other manufacturing</td>
<td>0% (no local corporate tax)</td>
<td>75%</td>
<td>Decreasing</td>
</tr>
<tr>
<td>2. Swiss onshore company</td>
<td>Life sciences, chemical, other manufacturing</td>
<td>5%–12% (lower rates via principal company ruling)</td>
<td>7%</td>
<td>Increasing</td>
<td></td>
</tr>
<tr>
<td>3. Irish resident company</td>
<td>Software, services, life sciences</td>
<td>1%–12.5% (rate depends on amortization and interest deductions)</td>
<td>5%</td>
<td>Increasing significantly</td>
<td></td>
</tr>
<tr>
<td>4. Benelux resident</td>
<td>Belgium or Dutch patent box regimes, Lux corporate or branch structures</td>
<td>Consumer products, chemical</td>
<td>1%–10% (Lux tends to be lower; Dutch patent box rate approximately 10%)</td>
<td>4%</td>
<td>Increasing</td>
</tr>
<tr>
<td>5. Singapore onshore company</td>
<td>Hardware, other manufacturing</td>
<td>0%/5%/10% (negotiated ruling)</td>
<td>2%</td>
<td>Increasing</td>
<td></td>
</tr>
<tr>
<td>6. Other resident companies</td>
<td>Malaysia, Puerto Rico, UK</td>
<td>Depends on nature of operations and specific tax incentives (e.g., holiday) and attributes (e.g., net operating losses)</td>
<td>~5-10%</td>
<td>Increasing</td>
<td></td>
</tr>
</tbody>
</table>

The reason for the decrease in the use of offshore structures is attributable to a variety of factors, including (1) increased sensitivity to the use of tax havens, (2) ensuring that intangible property (IP) returns are eligible for permanent establishment protection and reduced withholding tax rates under applicable income tax treaties, (3) responding to anti-tax haven legislation in many countries around the world, and (4) anticipating direction of US international tax reform. These considerations are further validated by the Organization for Economic Co-operation and Development (OECD) recent publication of a report on base erosion and profit shifting (BEPS Report). The BEPS Report has been endorsed by major trading powers, and further work and recommendations are being sought.
Handbook on transfer pricing risk assessment

► What questions should the tax administration seek to answer in a transfer pricing risk assessment process?
► How can the tax administration evaluate whether a taxpayer presents a material transfer pricing risk that justifies a detailed audit?
► Where can the tax administration get the information necessary to identify and assess transfer pricing risk?
► How can the tax administration organize itself to carry out an effective risk assessment?
► How can the tax administration most effectively interact with the taxpayer in assessing transfer pricing risk?
Key questions to consider due to CbC reporting

► Do you have accurate information on global operations? Headcount, revenues, profits by country
► Have you identified features listed as potentially indicative of transfer pricing (TP) risk?
  ► Significant transactions with a low tax jurisdiction
  ► Transfers of intangible property (IP) to related parties
  ► Business restructurings
  ► Specific types of related party payments
  ► Year on year loss making
  ► Poor or non-existent documentation
  ► Excessive debt
► Do you have amounts and supply chain charts for material transfer pricing transactions?
► What percent of transactions do you currently cover in documentation?

► How does your global footprint compare to your global tax footprint?
  ► Do you have more than 50% of profits outside jurisdictions where revenue is earned?
  ► Do you have aligned assets, functions and risks in your principal company?
  ► Is IP aligned with business substance?
  ► Do you earn consistent returns on similar transactions?
  ► How do the financials you used for a product or business unit analysis compare to the analyst reports being provided?
  ► Did you consider the full set of potentially comparable agreements in your analysis?
Transfer pricing audit roadmap

Implications

► TP cases “won and lost on the facts” – emphasizes importance of fact gathering for exam, but also for successful litigation:
  ► TP documentation increasingly important
  ► Known fact that transfer pricing practice (TPP) is searching for suitable test cases

► Increased scrutiny by sophisticated TP professionals

► Issue development takes precedence over speedy resolution

► Taxpayers can use the roadmap and the new Information Document Request (IDR) Directive as an opportunity to frame issues
Transfer pricing audit roadmap
Timeline
Managing the audit process

<table>
<thead>
<tr>
<th>Managing the audit</th>
<th>Audit strategy</th>
<th>Audit settlement</th>
</tr>
</thead>
</table>
| ► Key factors to successful audit outcome  
  ► Good communication  
  ► Good books and records  
  ► Quality documentation  
  ► Take control of the audit  
    ► Consistent audit strategy  
    ► Proactive presentation of facts  
  ► Reduce issues or requests  
  ► Managing, recording and monitoring communications | ► Auditors are more aggressive  
  ► Assess the team, team leaders  
  ► Prepare your personnel  
  ► Strategic consideration of involvement of other officials in the process  
  ► Prepare early for dispute resolution options – appeals, competent authority or APA | ► Negotiations can take place at various levels  
  ► When negotiations begin to fail with the auditor consider involving others  
  ► Take action well before reassessments are issued  
  ► Consider settlement impact on appeals and competent authority rights |
US Inbound Investment Update
<table>
<thead>
<tr>
<th>Treaty/Protocol</th>
<th>Signed</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>May 20, 2009</td>
<td>Protocol amended and approved by the Senate Foreign Relations Committee and referred to the full Senate for ratification on 1 April 2014.</td>
</tr>
<tr>
<td>Switzerland</td>
<td>September 23, 2009</td>
<td>Protocol amended and approved by the Senate Foreign Relations Committee and referred to the full Senate for ratification on 1 April 2014.</td>
</tr>
<tr>
<td>Chile</td>
<td>February 4, 2010</td>
<td>Treaty approved by the Senate Foreign Relations Committee and referred to the full Senate for ratification on 1 April 2014.</td>
</tr>
<tr>
<td>Hungary</td>
<td>February 4, 2010</td>
<td>Treaty approved by the Senate Foreign Relations Committee and referred to the full Senate for ratification on 1 April 2014.</td>
</tr>
<tr>
<td>Spain</td>
<td>January 14, 2013</td>
<td>Treaty approved by the Senate Foreign Relations Committee and referred to the full Senate for ratification on 15 August 2014.</td>
</tr>
<tr>
<td>Japan</td>
<td>January 24, 2013</td>
<td>Awaiting transmission by the President to the US Senate.</td>
</tr>
<tr>
<td>Poland</td>
<td>February 13, 2013</td>
<td>Treaty approved by the Senate Foreign Relations Committee and referred to the full Senate for ratification on 15 August 2014.</td>
</tr>
<tr>
<td>Norway</td>
<td>Not signed</td>
<td>Agreement on the text of the treaties has been reached.</td>
</tr>
<tr>
<td>Romania</td>
<td>Not signed</td>
<td>Agreement on the text of the treaties has been reached.</td>
</tr>
<tr>
<td>Vietnam</td>
<td>Not signed</td>
<td>4th round of treaty negotiations to take place.</td>
</tr>
</tbody>
</table>
Inbound focus: More proposed legislation

- Treaty override provision (H.R. 64)
  - Would amend the US Internal Revenue Code to deny treaty-based reductions for US withholding taxes on certain deductible payments made to a related party whose parent company is located in a country that does not have a treaty with the US
  - Would be effective for payments made after enactment
  - Scored to raise $7.7B over 10 years
- Provision has been introduced several times since 2007
- Prior versions have passed in the US House of Representatives but not in the US Senate