High Technology International Tax Symposium
Hyatt Regency – Santa Clara
25 March 2015
Welcome
<table>
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<th>Time</th>
<th>Session</th>
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<tr>
<td>8:00 am – 8:45 am</td>
<td>Registration and breakfast</td>
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<tr>
<td>8:45 am – 9:00 am</td>
<td>Introduction</td>
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<tr>
<td>9:00 am – 10:15 am</td>
<td>BEPS: its impact on technology companies and their operations</td>
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<tr>
<td>10:15 am – 10:30 am</td>
<td>Break</td>
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<td>10:30 am – 11:45 am</td>
<td>Your future structure</td>
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<td>11:45 am – 12:15 pm</td>
<td>Lunch</td>
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<td>12:15 pm – 1:00 pm</td>
<td>US legislation landscape</td>
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<td>1:00 pm – 2:15 pm</td>
<td>Acquisitions, dispositions and structuring</td>
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<td>2:15 pm – 2:30 pm</td>
<td>Break</td>
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<td>2:30 pm – 3:00 pm</td>
<td>India and China tax update</td>
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<tr>
<td>3:00 pm – 4:00 pm</td>
<td>Managing tax controversy and dispute resolutions</td>
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BEPS: Its impact on technology companies and their operations

High Technology International Tax Symposium

25 March 2015
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Contents

► Overview of BEPS: its impact on technology companies and their operations
► Action 13 and Country by Country reporting
► Selected local country developments
► UK Diverted Profits Tax
The BEPS Project addresses OECD and country concerns about the potential for multinational companies (MNCs) to reduce their tax liabilities by arbitrarily shifting income to no- or low-tax jurisdictions.

The OECD focuses its work on 15 target areas or “Action Items”.

Results of the work are ultimately expected to be reflected in a variety of forms, including:

- Reports and analysis
- Changes to the OECD model tax treaty, transfer pricing guidelines and related commentaries
- Development of a multilateral instrument to amend existing bilateral treaties
- Recommendations for changes in domestic tax law to be considered and adopted by participating countries

The following Action Items are of particular relevance to our clients with respect to their Intangible Property (IP) structures:

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<tr>
<th>Action item</th>
<th>Subject</th>
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<td>Action 1</td>
<td>Tax challenges of the digital economy</td>
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<td>Action 2</td>
<td>Hybrid mismatch arrangements</td>
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<td>Action 4</td>
<td>Limitations on interest deductions</td>
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<td>Action 5</td>
<td>Harmful tax practices</td>
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<td>Action 6</td>
<td>Addressing treaty abuse</td>
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<td>Action 7</td>
<td>Preventing the artificial avoidance of Permanent Establishment (PE) status</td>
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<td>Actions 8, 9 and 10</td>
<td>Assure that transfer pricing outcomes are in line with value creation – intangibles, risks and capital, special measures</td>
</tr>
<tr>
<td>Action 13</td>
<td>Transfer pricing documentation</td>
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## Action 1
Digital economy

<table>
<thead>
<tr>
<th>Digital Economy</th>
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<tbody>
<tr>
<td><strong>Description</strong></td>
</tr>
<tr>
<td>► Focus on new business models resulting from the evolution of information and communication technology (ICT)</td>
</tr>
<tr>
<td>► Direct tax concerns</td>
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<td>► VAT concerns</td>
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<tr>
<td>► Identifies the need to adapt CFC rules to the digital economy</td>
</tr>
<tr>
<td>► PE concerns (addressed by Action 7)</td>
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</table>

### Potential impact on IP planning

- Increased scrutiny expected for principal company structures related to allocation of functions and risks and the headcount performing the substantive functions
- Concerns about contractually allocating risk and legal ownerships of intangibles to entities in low tax jurisdictions, while undercompensating HQ for related risks and activities
- Potential impact on business of online sellers, in terms of treatment of local warehouses/ distribution centers and use of local subsidiaries to negotiate contracts
### Action 2
Hybrid mismatches

#### Hybrid mismatches

<table>
<thead>
<tr>
<th>Description</th>
<th>Status/next steps</th>
</tr>
</thead>
<tbody>
<tr>
<td>► Focus on designing rules to neutralize the mismatch effect of hybrid instruments and entities through domestic law and changes to tax treaties</td>
<td>► Report issued on 16 September 2014</td>
</tr>
<tr>
<td>► Recommends a mechanism of linking rules that would relate the tax treatment of a hybrid arrangement in one country to the treatment of such arrangement in the other country</td>
<td>► The OECD is continuing its work on Action 2 to address some technical and industry issues and implementation related issues</td>
</tr>
<tr>
<td>► Ordering rules with specified primary and defensive rules with respect to deductions and exemptions (either denying a deduction in the payor jurisdiction or mandating an inclusion in the payee jurisdiction)</td>
<td>► Final report expected in September 2015</td>
</tr>
<tr>
<td>► Applies to certain related-party transactions and “structured” arrangements</td>
<td>► Some countries have already implemented or proposed unilateral legislation on hybrids that reflect Action item 2 proposals (e.g., Mexico, Australia, France, Poland and Spain)</td>
</tr>
</tbody>
</table>

#### Potential impact on IP planning

 ► Recommendations, if enacted, would impact future planning if hybrid entities and other hybrid arrangements are used:

   ► Royalties paid to a tax-exempt IP Company
   ► Hybrid instruments that create deductions for an IP principal (e.g., Luxembourg PECS/IPPECS structures)
# Action 4
Limitations on interest deductions

<table>
<thead>
<tr>
<th><strong>Description</strong></th>
<th><strong>Status/next steps</strong></th>
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</thead>
<tbody>
<tr>
<td>► Main focus of discussion draft is alternative proposals for limiting interest deductions</td>
<td>► The OECD issued discussion draft on 18 December 2014</td>
</tr>
<tr>
<td>► By reference to the amount of external interest of the MNC group allocated across group based on earnings/assets</td>
<td>► The OECD held an invitational consultation on the discussion draft on 21 January 2015, received 1000+ pages of comments, and held a public consultation on 17 February 2015</td>
</tr>
<tr>
<td>► By reference to a fixed ratio of entity’s earnings/assets</td>
<td>► Some countries have made changes to reduce the allowable debt to equity thresholds (e.g., Australia, Korea and Poland)</td>
</tr>
<tr>
<td>► Draft also considers proposals that would combine the two alternative approaches</td>
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</table>

**Potential impact on IP planning**

► Recommendations, if enacted, would limit the ability to reduce taxable income in high tax jurisdictions
# Action 5
## Countering harmful tax practices

### Description
- The report on Action 5 relates to the OECD’s review of member country preferential regimes
  - Additional work targeted for completion in 2015 includes development of a strategy to expand participation to non-OECD countries
- The report focuses on two areas:
  - With respect to intangible property (IP) regimes, the report discusses options for a substantial activity requirement, including a “nexus” test
  - With respect to transparency, the report discusses development of a framework for compulsory spontaneous exchange of information by tax administrations on taxpayer specific rulings and APAs
    - The sharing of rulings and APAs also is contemplated in the master file/local file framework for transfer pricing documentation under Action 13

### Status/next steps
- The OECD on 6 February 2015 released a paper describing agreement on a modified nexus approach for substantial activity in IP regimes and additional work to be done on tracking requirements and grandfathering
- Some countries have enacted patent box regimes that are purported to be in line with the modified nexus approach while other countries are considering changes to bring regimes in line with such approach (e.g. UK)

### Potential impact on IP planning
- Would need to consider the potential substantial activity requirement, including a “nexus” test, for IP regimes
### Action 6
Addressing treaty abuse

<table>
<thead>
<tr>
<th>Description</th>
<th>Status/next steps</th>
</tr>
</thead>
<tbody>
<tr>
<td>► The OECD’s recommendations with respect to addressing treaty abuse include three elements:</td>
<td>► Continuing work includes technical details of the proposed rules, particularly the LOB rule, and more work on treaty benefits for collective investment vehicles and other investment funds</td>
</tr>
<tr>
<td>► Model treaty provisions and domestic law changes to prevent the granting of treaty benefits in inappropriate circumstances</td>
<td>► OECD issued a discussion draft on 21 November 2014 on this follow-up work</td>
</tr>
<tr>
<td>► Changes to the title and preamble of the OECD model treaty to clarify that treaties are not intended to be used to generate double non-taxation</td>
<td>► OECD received 700+ pages of comments and held a public consultation on 22 January 2015, where business commentators stressed the importance of ensuring that new rules do not impose undue burdens on access to treaty benefits</td>
</tr>
<tr>
<td>► Policy considerations with respect to countries’ decisions to enter into treaties</td>
<td></td>
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<tr>
<td>► Draft also considers proposals that would combine the two alternative approaches</td>
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</table>

### Potential impact on IP planning

► The recommendation regarding addressing potential “treaty shopping” provides alternative options:

► Adoption of both a US-style limitation on benefits (LOB) rule and a general anti-abuse rule in the form of a principal purpose test (PPT) (which is the OECD preferred approach)

► Adoption of a PPT

► Adoption of an LOB rule supplemented by a mechanism, such as a restricted PPT rule applicable to conduit financing arrangements or domestic anti-abuse rules or judicial doctrines that would achieve a similar result
## Action 7
Preventing the artificial avoidance of PE status

### Description
- Calls for changes to the definition of PE to prevent the artificial avoidance of PE status through the use of commissionaire arrangements and the activity exemptions
- Discusses various aspects of the PE definition that could give rise to BEPS concerns and identifies strategies that avoid PE status

### Status/next steps
- Public discussion draft issued 31 October 2014
- Final deliverable expected in September 2015
- Proposed changes to be considered for inclusion in next update to the OECD Model Treaty
- Guidance on profit attribution to PE

### Potential impact on IP planning
- OECD has proposed several options that if adopted, would lower the threshold for creating a PE and expand the definition of a dependent agent PE
  - Commissionaire or similar arrangements, commission agents and service providers operating models may be impacted
    - Impact on (combined) remuneration?
  - Specific activity exemptions limited to preparatory or auxiliary activities only
  - Potential impact on:
    - Warehousing/delivery activities of e-Commerce entities
    - Principal companies with inventory in a local country (as a result of tolling arrangements)
    - Principal companies with regional distribution centre
    - Representative/purchasing offices (e.g., representative offices in Asia)
    - Other structures where functions are separated (e.g., engineering and construction companies)
### Action 8
Transfer pricing for intangibles

#### Description
- Recommendations contain revised standards for transfer pricing of intangibles, including:
  1. The definition of intangibles
  2. Identifying and characterizing controlled transactions involving intangibles
  3. Determining arm’s length conditions for transactions involving intangibles
  4. Ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation (DEMPE) functions

#### Status/next steps
- Report issued 16 September 2014
- Final pronouncements on the issues of risk, recharacterization and “special measures” expected in September 2015
  - Developing transfer pricing rules or special measures for transfers of hard to value intangibles
  - Updating the guidance on cost contribution arrangements

#### Potential impact on IP planning
- DEMPE functions – develop, enhance, maintain, protect and exploit – need to be assessed when determining if an MNC group member is entitled to any intangible related return
  - Legal ownership and the funding of the development of an intangible, without performing and controlling all of the functions, would not lead to an entitlement to (all) returns derived from the exploitation of such intangible
  - Legal owners who outsource key DEMPE functions not entitled to (all) IP returns
  - Profit splits are suggested when key DEMPE functions are outsourced
  - If DEMPE contributors are remunerated on a one-sided basis, reliability of transfer pricing reduced
  - Allows for a risk-adjusted rate of return to pure funders, but funder must manage the financial risks
## Actions 9 and 10
Transfer pricing (TP) for risks and capital and other high-risk transactions

### Transfer pricing for risks and capital and other high-risk transactions

<table>
<thead>
<tr>
<th>Description</th>
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<tbody>
<tr>
<td>► TP guidance for low value-adding intra-group services to provide protection against common types of base eroding payments (management fees and head office expenses)</td>
</tr>
<tr>
<td>► Adopting TP rules/special measures to clarify situations wherein transactions can be recharacterized</td>
</tr>
<tr>
<td>► Develop rules on use of profit splits in the context of global value chains</td>
</tr>
<tr>
<td>► Adopting TP rules with respect to cross-border commodity transactions</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Status/next steps</th>
</tr>
</thead>
<tbody>
<tr>
<td>► Discussion drafts released on 3 November, 16 December and 19 December 2014 but do not represent a consensus view</td>
</tr>
<tr>
<td>► Several questions posed to reviewers throughout the draft</td>
</tr>
<tr>
<td>► Final draft expected September 2015</td>
</tr>
</tbody>
</table>

### Potential impact on IP planning

| ► Additional scrutiny of TP for low value-adding services (management/head office services) and proper documentation should be maintained |
| ► Shareholder costs should be retained by shareholder |
| ► Duplicative services, incidental benefit, and passive association benefits should not be charged |
| ► Direct charge methods are favored |
| ► Greater emphasis on parties’ commercial and financial conduct, notwithstanding characterization in inter-company agreements |
| ► Possible recharacterization of a license contract as a service, when licensee bears insufficient risk or management responsibility |
| ► Contractual allocation of risk without sufficient control will not be regarded as arm’s length |
| ► Profit splits may be used to divide residual income after paying a cost plus remuneration to limited function entities – using production capacity, headcount and value of production to split |
# Action 13 and country-by-country reporting

TP documentation and country-by-country reporting

<table>
<thead>
<tr>
<th><strong>Master File</strong></th>
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</thead>
<tbody>
<tr>
<td>Overview of the MNE group business, its overall TP policies and global allocation of income in a single document</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Local file</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Detailed information about the local business, including related-party payments and receipts for products, services, royalties, interest, etc.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Country-by-Country (CbC) report</strong></th>
</tr>
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<tbody>
<tr>
<td>High-level aggregated financial information by jurisdiction, including profits, revenues, employees and assets</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Status/next steps</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Final report released 16 September 2014</td>
</tr>
<tr>
<td>Next Action 13 guidance by April 2015</td>
</tr>
<tr>
<td>Guidelines on implementation and filing published in February 2015:</td>
</tr>
</tbody>
</table>

- **Filing**: Generally ultimate parent to file CbC report in jurisdiction of residence
- **Timing**: First set of CbC reports to be filed by 31 December 2017 for fiscal years beginning on 1 January 2016 (in other cases, the term for filing will be one year from the close of the fiscal year)
- **Exemption** from filing for MNE groups with annual consolidated group revenues < € 750m
- Framework for obtaining and exchanging CbC reports and an implementation package will be developed by April 2015
- Master File and Local File to be delivered directly to all tax authorities in countries where an MNC does business
Selected local country developments

- On 26 February 2015, a think tank affiliated with the French Government issued a report entitled
  “Taxation and the digital economy: A survey of theoretical models”

- The Report recommends a three-tiered approach to taxing digital economy:
  - (i) adaptation of nexus rules on the taxation of profits (i.e., the definition of a permanent establishment) via international negotiations;
  - (ii) if and as long as the previous approach is not implemented, adoption of an ad valorem taxation based on revenue (e.g., advertising revenue) generated in the jurisdiction;
  - (iii) if and as long as neither of the previous approaches is implemented, adoption of a tax based on a measure of activity (e.g., number of users, flow of data or number of advertisers)
Selected local country developments

Irish tax residency rules
► In December 2014’s Finance Act, Ireland introduced a change to the Irish tax residency rules for companies incorporated in Ireland but tax resident outside of Ireland
► Companies incorporated in Ireland on or after 1 January 2015 will be regarded as Irish tax resident absent a treaty override
► Rule change will affect so-called “Double-Irish” structures – where an Irish tax resident pays a deductible royalty to an Irish incorporated but Irish non-resident IP owner – (e.g., resident in Bermuda); such structures will be shut down for existing investors at the end of a grandfathering period which runs through 2020

Switzerland – Corporate tax reform
► On 22 September 2014, the Federal Council presented the legislative consultation draft of the Swiss Corporate Tax Reform (CTR III) – expected to become effective sometime between 2018 – 2020
► Switzerland aims to have a sustainable, internationally accepted and competitive tax system for MNCs taking into account OECD and EU developments

EU Hybrid Rules
► Proposals to implement EU hybrid rules that would deny the benefit of intra-EU hybrids
Selected local country developments

Luxembourg
► As of 1 January 2015, a provision providing a more robust legal framework to the tax ruling practice was incorporated into the General Tax Code
  ► The pre-existing transfer pricing rule was replaced by a provision largely inspired by the arm’s length principle as set forth by the 2010 OECD TP Guidelines
  ► The taxpayer has to justify the data contained in its tax returns with appropriate information and documentation is formally extended to transfer pricing matters

Germany
► In December 2014, Germany announced that it is going to implement the OECD BEPS project results as released in 2015 into a tax bill; would likely impact reverse hybrid KG structures and other hybrid arrangements

France
► With the year-end 2014 tax bill, France has introduced a provision addressing inbound hybrid payments (taking effect for fiscal years that begin on or after 1 January 2015)

China
► GAAR
► Base Erosion and BEPS
UK Diverted Profits Tax (DPT) – overview

- A new tax to deal with “aggressive avoidance” by multinational companies making sales in the UK
- A response to political and public pressure in the UK, aligned to the wider BEPS agenda
- DPT is a new tax
  - Not covered by existing double tax treaties
  - Cannot offset existing corporation tax losses, (e.g. stock option deductions)
- Companies must make disclosure to HMRC of potential liability to DPT
- HMRC will then issue charging notice if appropriate
UK Diverted Profits Tax (DPT)

- 25% tax on profits diverted from UK to a low tax company ("Section 80 charge") or by avoiding a PE ("Section 86 charge")
- All companies with deferral structure and UK sales at risk from 1 April 2015 where entity or transaction with 'insufficient economic substance'
- No formal clearance mechanism other than APA
  - APA will not be agreed without full visibility on supply chain
  - Law allows for informal agreement of no DPT notification by 'an officer of HMRC,' (i.e., Customer Relationship Manager)
- Initial tax charge could be based on disallowance of 30% of royalty paid out to NRI/CV/SwissCo
- Tax payable within 30 days of charging notice, no TP defense
- Tax not recoverable until DPT profits agreed
S80: Charging notice example

- UKCo has sales of $1b, with cost of goods sold (COGS) paid to Ireland of $700m
  - Assuming 2% Return On Sales, UK profits would be $20m, with UK corporation tax payable $4m
- Ireland pays royalty to Cayman of $500m in respect of sales connected with UK activities
- HMRC raises DPT charging notice on UKCo., assuming no recharacterization, DPT profits are likely based on 30% of $700m (i.e., $210m)
  - Initial DPT is 25% of $210m (i.e., $52.5m)
- Likely to be significantly higher than final DPT charge, which is based on OECD transfer pricing principles (unless IP previously in the UK)
- Charging notices also likely to be raised for all years until agreement is reached with HMRC
S86: Charging notice example

- Ireland has sales of $2b connected with UK activities (of which sales in UK are $1b), with royalty paid to Cayman on the same sales of $1.4b
  - UK sales and marketing support earns a return of $20m on UK sales only, with UK corporation tax payable $4m
- HMRC raises DPT charging notice on Ireland (but can assess tax on UK related parties if Ireland does not pay)
- Assuming no recharacterization, initial DPT profits are likely based on 30% of $1.4b (i.e., $420m)
  - **Initial DPT is 25% of $420m (i.e., $105m)**
  - Likely to be significantly higher than final DPT charge, which is likely based on combined distributor/master distributor margin – with higher percentage for sales in UK than EMEA
  - Charging notices also likely to be raised for all years until agreement is reached with HMRC
Haven IP owner with onshore distributor
(e.g., Ireland, NL, Swiss, Singapore (Section 86))

DPT issues

► Assume relevant PE Avoidance conditions for DPT are met
► S86 will charge profits of the “avoided PE” to DPT
► Haven has low tax rate and low substance
► DPT will examine the whole supply chain to determine what profits should be taxed in the avoided PE
► OECD guidance suggests only limited profits should arise in Haven due to lack of substance; Should excess Haven profits be taxed on PE?
► Likely HMRC will issue preliminary assessment based on 30 per cent disallowance of royalty of deemed PE unless tax payer takes action to remediate
Haven IP owner with buy sell distributors (Section 80)

DPT issues

Royalty to Haven IPCo

► Assume relevant DPT conditions are met (Section 80 case)
► Haven has low tax rate and substance
► DPT will examine the whole supply chain
► If royalty paid to Haven is excessive, UK derived proportion of excess will be taxed on UKCo
► Likely HMRC will issue preliminary notice based on 30% disallowance of distributor license unless company takes action
What next?

► DPT will apply from 1 April 2015
► Need to consider impact on ETR from Q1 2015
► Companies need to consider whether they are potentially in charge to DPT
  ► Notification requirement 3 months after year end (6 months during transitional period, (i.e., periods ending prior to 31 March 2016))
  ► Impact on UK subsidiaries if 25% tax on 30% of royalties is payable
► Are transfer pricing documentation and internal procedures adequate to displace assessment to DPT?
  ► What happens in Haven IPCo? Is this documented adequately?
► Is structure fit for purpose?
► Consider impact of DPT audit on earlier years
Short term actions

- Assess whether DPT is likely to apply and need for notification
- Estimate of exposure
  - 30% disallowance?
  - Rule of thumb profit split?
- Develop strategy for dealing with DPT and notification requirement
  - HMRC engagement?
    - APA program? CRM risk assessment?
- Defense strategy
  - Transfer pricing methodology
  - Substance vs profitability assessment
  - Operational and TP documentation
Break
Your Future Structure

High Technology International Tax Symposium

25 March 2015
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Themes

► IP Alignment: Current “Offshore” Structures
  ► Transfer pricing and DEMPE functions
  ► Permanent establishment standard
    ► Treaty qualification
    ► UK Diverted Profits Tax
  ► Foreign base company sales considerations

► IP Alignment: Moving to “Onshore” Structures
  ► IP valuation and method of transfer
  ► Availability and sustainability of incentives

► Operating Model: Mix of Products and Services
  ► Central vs. local contracting (or both)
  ► Foreign base company services considerations
Current global expansion structures

Organizational structure
► (Non)-US IP transferred/owned by Dutch limited partnership (Dutch CV)
► Dutch Principal operates under a license from Dutch CV and acts as central supply chain hub
► Dutch Principal sells products or provides services directly to customers and/or through related parties

Benefits / Dutch tax considerations
► The profit margin to be reported by Dutch Principal is determined by an OECD conform transfer pricing report and agreed upon with the Dutch tax authorities in an Advanced Pricing Agreement (APA)
► Dutch Principal pays a deductible royalty to Dutch CV
► The royalty paid by Dutch Principal to Dutch CV is equal to the profit realized by the Dutch Principal in excess of the arm’s length remuneration
► The royalty paid by Dutch Principal to Dutch CV should not be taxed in the Netherlands
► No royalty withholding tax on royalty payments
► CV should be considered a foreign corporation for US federal income tax purposes. As such, the profit of the CV should not be subject to US federal income tax (deferral)

** Dutch structure is similar to mechanics and pricing of “Double Irish” structure with Irish nonresident company in place of CV IP Co. and Irish trading company in place of Dutch Principal BV
Current global expansion structures
Considerations

► US tax considerations
  ► Foreign base company sales income
    ► Consider impact of GLAM 2015-002
      ► What is the most appropriate method of calculating the actual effective rate of tax and the hypothetical effective rate of tax for purposes of determining whether there is tax rate disparity pursuant to the regulations under section 954(d)(2) in the case of property manufactured by a CFC?
    ► IRS Conclusion:
      ► In the case of property manufactured by a CFC, the most appropriate method of calculating the actual effective rate of tax and the hypothetical effective rate of tax is to divide the actual tax and the hypothetical tax by the hypothetical tax base determined under the laws of the manufacturing jurisdiction
  ► Substantial contribution considerations
    ► Industry trends
    ► Audit experience
Current global expansion structures
Considerations

► Substance considerations
  ► Consider board meeting requirements to manage IP
  ► Formation of IP Committees
  ► Treaty qualification
  ► Need for DEMPE functions?
    ► OECD standard versus Treas. Reg. 1.482-1

► Transfer Pricing
  ► Compensation for principal and local distributors
  ► Availability of APAs (Europe vs. Emerging Markets)
  ► Cost-plus vs. gross margin vs. profit split
UK Diverted Profits Tax

► 25% tax on profits diverted from UK to a low tax company ("Section 3 Charge") or by avoiding a PE ("Section 2 Charge")

► All companies with deferral structure and UK sales at risk from 1 April 2015

► No clearance mechanism other than APA, which will not be agreed without full visibility on supply chain

► Initial tax charge could be based on disallowance of 30% of royalty paid out to NRI/CV/Swissco

► Tax payable within 30 days, no TP defense

► Tax not recoverable until DPT profits agreed
Future state global (onshore) structures

Organizational structure
- Existing (non)-US IP is transferred to Principal
- Principal can finance IP with a mix of debt and equity.
- Non-US IP may be further developed by or on behalf of Principal
- Principal sells products or provides services directly to customers and/or through related parties
- Note: Transition from offshore structure into onshore structure should be flexible

Tax considerations
- Principal should receive fair market value of the IP (may be in the form a note)
- Amortization of IP possible, with flexibility in amortization method
- Interest expenses (on IP acquisition loan) and amortization of IP can be expensed against income.
- Newly developed IP can benefit from the Innovation or patent box regimes
- Exit and/or significant change in value can be mitigated (e.g. through price adjustment)
- R&D credits and other tax incentives available for qualifying costs
Transfer pricing considerations

- Transfer pricing governed by local rules of the onshore entity and the OECD Guidelines, including Action 8 Guidance on Transfer Pricing Aspects of Intangibles
  - Identification and categorization
    - Revised OECD definition of intangibles
    - Examples include patents, know-how, trade secrets, trademarks, trade names, brand, contracts, licenses, goodwill/going-concern value, synergies, market characteristics
  - Valuation
    - Methodology
      - Income based valuation techniques may be useful
      - Key inputs include forecasts, discount rates, useful life of intangibles and treatment of taxes
    - Amortization
    - Repeal of ARB 51
Transfer pricing considerations

- Ongoing returns to intangibles due to the entity involved in the DEMPE activities
  - Development
  - Enhancement
  - Maintenance
  - Protection
  - Exploitation

- Local distribution
  - Methodology
  - Impact of contracting model
  - Local intangibles/PE considerations
Operating Model: Mix of Products and Services

► Contracting model
  ► Central vs. local contracting (or both)
  ► Transfer pricing and PE
  ► Cost sharing implications

► Foreign base company services considerations
  ► Substantial assistance (Notice 2007-13)
Questions
Lunch
US Legislative Landscape

High Technology International Tax Symposium

25 March 2015
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► Curt Kinsky (Moderator)  
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## Agenda

<table>
<thead>
<tr>
<th>Topic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legislative timeline</td>
</tr>
<tr>
<td>Tax reform</td>
</tr>
<tr>
<td>FY2016 Obama Administration Budget</td>
</tr>
<tr>
<td>Tax extenders</td>
</tr>
<tr>
<td>Global landscape</td>
</tr>
<tr>
<td>Appendix – Camp Tax Reform Act of 2014</td>
</tr>
</tbody>
</table>
Legislative agenda and deadlines

31 March 2015
Medicare “doc fix” expires

31 May 2015
Highway funding authorization expires

30 September 2015
► Government funding expires
► Internet Tax Freedom Act expires
► Airport and Airway Trust Fund expires
► Children’s Health Insurance Program expires

Debt limit suspension expired*
15 March 2015

Export-Import Bank charter expires
30 June 2015

*Treasury can meet obligations until October or November, however

Potential agenda items, aside from deadlines

► FY 2016 Budget Resolution
► Tax reform
► Tax extenders
► Curtailing EPA regulations
► Trade
► Cybersecurity

► Appropriations bills
► Affordable Care Act
  ► Response to King vs. Burwell
  ► Definition of full-time employee
  ► Medical device excise tax repeal
  ► Cadillac tax
US tax reform – policy considerations and challenges

Scope – Business-only tax reform vs. comprehensive tax reform, including individual tax reform

Revenue issues
  - Target (i.e., revenue neutral, raise revenue, etc.)
  - How to measure revenue
  - Time period for measurement

International tax reform
  - Increase US competitiveness relative to trading partners that have lower corporate income tax rates and territorial tax systems
  - Address the “lock-out” effect of foreign earnings while strengthening anti-base erosion rules
  - Common ground exists, but ideological differences and details are hindering efforts to advance the debate
US tax reform – policy considerations and challenges

► Business tax reform
  ► How should pass-throughs be addressed?

► Individual tax reform
  ► Should rates go down or be increased for high-income taxpayers (including on capital gains and dividend income)?
  ► How should popular individual tax preferences and deductions be addressed?
## Sharp reductions in corporate tax rates abroad

<table>
<thead>
<tr>
<th>Country</th>
<th>2000 statutory corporate tax rate*</th>
<th>2014 statutory corporate tax rate*</th>
<th>Percent change</th>
</tr>
</thead>
<tbody>
<tr>
<td>G-7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>43.3</td>
<td>26.4</td>
<td>(39.0)</td>
</tr>
<tr>
<td>France</td>
<td>37.8</td>
<td>36.1</td>
<td>(4.4)</td>
</tr>
<tr>
<td>Germany</td>
<td>52.0</td>
<td>30.2</td>
<td>(42.0)</td>
</tr>
<tr>
<td>Italy</td>
<td>39.5</td>
<td>31.4</td>
<td>(20.4)</td>
</tr>
<tr>
<td>Japan</td>
<td>43.3</td>
<td>35.6</td>
<td>(17.7)</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>30.0</td>
<td>21.0</td>
<td>(30.0)</td>
</tr>
<tr>
<td>United States</td>
<td>39.4</td>
<td>39.0</td>
<td>(1.0)</td>
</tr>
<tr>
<td>BRIC</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>34.0</td>
<td>34.0</td>
<td>–</td>
</tr>
<tr>
<td>Russia</td>
<td>35.0</td>
<td>20.0</td>
<td>(42.9)</td>
</tr>
<tr>
<td>India*</td>
<td>42.0</td>
<td>34.0</td>
<td>(19.1)</td>
</tr>
<tr>
<td>China</td>
<td>33.0</td>
<td>25.0</td>
<td>(24.2)</td>
</tr>
</tbody>
</table>

The 2013 corporate income tax rates are shown for India. Reliable corporate tax rates incorporating other charges such as surcharges or cesses for India for the tax year beginning April 2014 are not available.

*Includes both national and sub-national revenues.

Note: Japan’s corporate income tax surcharge—part of the Great East Japan Earthquake restoration measures—has been repealed for the tax year beginning 1 April 2014. The surcharge was expected to be in effect for one more year. The 2013 tax rates indicated here for India reflect those applicable to companies with greater than INR 100 million of income (approximately US$1.6 million). It has been suggested that the United States has a relatively low average effective corporate tax rate. However, recent research has found that the United States has a relatively high average effective corporate tax rate relative to its major trading partners. Only global companies in Japan and Germany have higher average effective corporate tax rates. See Barbara Angus, Tom Neubig, Eric Solomon and Mark Weinberger, “The US International Tax System At a Crossroads,” Tax Notes, 5 April 2010, pp. 45-65.
## Taxation of foreign-source income

<table>
<thead>
<tr>
<th>Country</th>
<th>Worldwide/territorial</th>
<th>Foreign-source dividend exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Austria</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Belgium</td>
<td>Territorial</td>
<td>95%</td>
</tr>
<tr>
<td>Canada</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Chile</td>
<td>Worldwide</td>
<td>0%</td>
</tr>
<tr>
<td>Czech republic</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Denmark</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Estonia</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Finland</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>France</td>
<td>Territorial</td>
<td>95%</td>
</tr>
<tr>
<td>Germany</td>
<td>Territorial</td>
<td>95%</td>
</tr>
<tr>
<td>Greece</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Hungary</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Iceland</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Ireland</td>
<td>Worldwide</td>
<td>0%</td>
</tr>
<tr>
<td>Israel</td>
<td>Worldwide</td>
<td>0%</td>
</tr>
<tr>
<td>Italy</td>
<td>Territorial</td>
<td>95%</td>
</tr>
<tr>
<td>Japan</td>
<td>Territorial</td>
<td>95%</td>
</tr>
<tr>
<td>Korea</td>
<td>Worldwide</td>
<td>0%</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Mexico</td>
<td>Worldwide</td>
<td>0%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Norway</td>
<td>Territorial</td>
<td>97%</td>
</tr>
<tr>
<td>Poland</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Portugal</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Territorial</td>
<td>95%</td>
</tr>
<tr>
<td>Spain</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Sweden</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Territorial</td>
<td>95%</td>
</tr>
<tr>
<td>Turkey</td>
<td>Territorial</td>
<td>100%</td>
</tr>
<tr>
<td>United States</td>
<td>Worldwide</td>
<td>0%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Territorial</td>
<td>100%</td>
</tr>
</tbody>
</table>
Latest on tax reform

White House
► FY16 budget contains new international tax proposals and a “reserve” for revenue-neutral business tax reform
► 2012 Framework for Business Tax Reform
► Does not have a completely detailed plan

House Ways and Means Committee
► Chairman Ryan will exhaust opportunities to find common ground with President before putting out own plan: “I don’t want to waste two years waiting for another chance”
► Agreement must happen by end of summer, Ryan says, because presidential politics will interfere beyond then
Latest on tax reform – Senate Finance Committee

► Five Tax Reform Working Groups
  ► Goal - to ‘examine policy trade-offs and available reform options,’ make recommendations for comprehensive report completed by 31 May

► Hatch: business tax reform may be ‘all we can do’
  ► President focused solely on business, ‘would like him to go farther’
  ► Requesting detailed plan from White House
  ► Effort will probably take more than two years

► Chairman/Democrats have separate lists of seven principles

<table>
<thead>
<tr>
<th>Chairman Hatch tax reform principles</th>
<th>Committee Democrats’ principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>economic growth</td>
<td>focus on supporting domestic jobs</td>
</tr>
<tr>
<td>fairness</td>
<td>make the system more progressive</td>
</tr>
<tr>
<td>simplicity</td>
<td>consideration of how proposals affect industries, regions</td>
</tr>
<tr>
<td>permanence</td>
<td>avoid “unproven revenue-estimating methods”</td>
</tr>
<tr>
<td>competitiveness</td>
<td>corporate tax system is internationally competitive</td>
</tr>
<tr>
<td>promoting savings and investment</td>
<td>process through regular order, not reconciliation</td>
</tr>
<tr>
<td>revenue neutrality</td>
<td>revenue base adequate for meeting the country’s needs</td>
</tr>
</tbody>
</table>
## Senate Finance Committee Tax Working Groups

### Individual Income Tax
- **Co-Chair Chuck Grassley** (R-IA)
- **Co-Chair Mike Enzi** (R-WY)
- **Mike Crapo** (R-ID)
- **John Cornyn** (R-TX)
- **Pat Toomey** (R-PA)
- **Co-Chair Debbie Stabenow** (D-MI)
- **Charles Schumer** (D-NY)
- **Bill Nelson** (D-FL)
- **Robert Menendez** (D-NJ)
- **Michael Bennet** (D-CO)

### Business Income Tax
- **Co-Chair John Thune** (R-SD)
- **Pat Roberts** (R-KS)
- **Richard Burr** (R-NC)
- **Johnny Isakson** (R-GA)
- **Rob Portman** (R-OH)
- **Co-Chair Ben Cardin** (D-MD)
- **Debbie Stabenow** (D-MI)
- **Tom Carper** (D-DE)
- **Bob Casey** (D-PA)
- **Mark Warner** (D-VA)
- **Robert Menendez** (D-NJ)

### Savings and Investment
- **Co-Chair Mike Crapo** (R-ID)
- **Richard Burr** (R-NC)
- **Johnny Isakson** (R-GA)
- **Rob Portman** (R-OH)
- **Co-Chair Sherrod Brown** (D-OH)
- **Ben Cardin** (D-MD)
- **Bob Casey** (D-PA)
- **Mark Warner** (D-VA)
- **Robert Menendez** (D-NJ)

### International Tax
- **Co-Chair Rob Portman** (R-OH)
- **Pat Roberts** (R-KS)
- **Michael Enzi** (R-WY)
- **John Cornyn** (R-TX)
- **Co-Chair Charles Schumer** (D-NY)
- **Sherrod Brown** (D-OH)
- **Tom Carper** (D-DE)
- **Mark Warner** (D-VA)
- **Bill Nelson** (D-FL)

### Community Development and Infrastructure
- **Co-Chair Dean Heller** (R-NV)
- **Dan Coats** (R-IN)
- **Co-Chair Michael Bennet** (D-CO)
- **Maria Cantwell** (D-WA)
- **Tim Scott** (R-SC)
- **Bill Nelson** (D-FL)
FY16 budget released on 2 February 2015

International tax proposals
- Eight new proposals
- Three would revise proposals contained in the FY15 budget
- Fifteen are substantially similar to the FY15 budget
- Three of the FY15 budget proposals were dropped

The international tax proposals include a minimum tax proposal

Some proposals appear to reflect initiatives that are in line with the tax policy work undertaken as part of the OECD Base Erosion and Profit Shifting (BEPS) project
Obama administration FY16 budget – new international proposals

- Eight new international tax-related proposals
  - Impose a 19% minimum tax on foreign income
  - Impose a one-time 14% tax on previously untaxed foreign income
  - Repeal delay in the implementation of worldwide interest allocation
  - Permanently extend the exception under subpart F for active financing income
  - Permanently extend the look-through treatment of payments between related controlled foreign corporations (CFCs)
  - Amend the CFC attribution rules of section 958(b)
  - Eliminate the 30-day rule under section 951(a) with respect to subpart F inclusions
  - Treat purchases of hook stock by a subsidiary as giving rise to deemed distributions
Three international tax-related proposals that reflect revisions from prior year

- Restrict deductions for excessive interest of members of financial reporting groups;
- Limit the ability of domestic entities to expatriate; and
- Prevent use of leveraged distributions from related corporations to avoid dividend treatment
Obama administration FY16 budget – carryover international proposals

► The remaining 15 international tax proposals are substantially similar to the proposals included in FY2015

► Provide incentives for locating jobs and business activity in the United States and deny tax deductions for activity considered to involve “shipping jobs overseas”

► Limit shifting of income through intangible property transfers

► Disallow deduction for excess non-taxed reinsurance premiums paid to affiliates

► Modify the treatment of dual capacity taxpayers

► Tax gain from the sale of a partnership interest on a look-through basis

► Remove foreign taxes from a section 902 corporation’s foreign tax pool when earnings are eliminated

► Extend section 338(h)(16) to certain asset acquisitions

► Restrict the use of hybrid arrangements that create stateless income
Obama administration FY16 budget – carryover international proposals (cont’d)

- Limit the application of exceptions under subpart F for certain transactions that use reverse hybrids to create stateless income
- Create a new category of subpart F income for transactions involving digital goods or services
- Expand foreign base company sales income to include manufacturing services arrangements
- Exempt foreign pension funds from application of the Foreign Investment in Real Property Act (FIRPTA) provisions
- Provide for reciprocal reporting of information in connection with implementation of the Foreign Account Tax Compliance Act (FATCA) provisions
- Prevent the elimination of earnings and profits (E&P) through distributions of certain stock with basis attributable to dividend equivalent redemptions
- Repeal gain limitation for dividends received in reorganization exchanges
Tax extenders

- Late last year, Congress passed legislation to retroactively extend 55 tax provisions, but only through 2014
  - Did not include revenue offsets for $41.6b, 10-year cost
- Extenders will need to be revisited this year either as part of tax reform or independently
- Full House and Ways and Means Committee have approved bills to make some provisions permanent with no revenue offsets
  - Chairman Ryan: effort intended to facilitate tax reform by making baseline more accurate and truthful
  - Rep. Levin: Republicans want provisions in baseline so they don’t have to be offset in tax reform, allowing for additional rate reduction
- The Senate is unlikely to take up the individual House bills, meaning absent enactment of tax reform or an agreement on a package that would make selected extenders permanent, a short-term extension of expired provisions is expected later this year
## Tax extenders (cont’d)

<table>
<thead>
<tr>
<th>Bill</th>
<th>10-year cost</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Approved by House</strong></td>
<td></td>
</tr>
<tr>
<td>- permanently extend and expand the charitable deduction for</td>
<td></td>
</tr>
<tr>
<td>contributions of food inventory</td>
<td></td>
</tr>
<tr>
<td>- permanent IRA charitable rollover provision</td>
<td></td>
</tr>
<tr>
<td>- permanent increased percentage limits and extended carry-forward</td>
<td></td>
</tr>
<tr>
<td>period for qualified conservation contributions</td>
<td></td>
</tr>
<tr>
<td>- modify tax rate for excise tax on investment income of private</td>
<td></td>
</tr>
<tr>
<td>foundations</td>
<td></td>
</tr>
<tr>
<td>H.R. 636, <em>America’s Small Business Tax Relief Act</em>, by 272-142 vote</td>
<td>-$79.2 billion</td>
</tr>
<tr>
<td>- permanent increased ($500,000) expensing under Section 179</td>
<td></td>
</tr>
<tr>
<td>- permanent reduced recognition for built-in gains of S corporations</td>
<td></td>
</tr>
<tr>
<td>- permanent rules regarding basis adjustments to stock of S</td>
<td></td>
</tr>
<tr>
<td>corporations making charitable contributions of property</td>
<td></td>
</tr>
<tr>
<td>(non-extender) H.R. 529, to improve 529 plans, by 401-20 vote</td>
<td>-$51 million</td>
</tr>
<tr>
<td><strong>Approved by Ways and Means Committee</strong></td>
<td></td>
</tr>
<tr>
<td>H.R. 880, to enhance, simplify, and make permanent the R&amp;D credit</td>
<td>-$181.6 billion</td>
</tr>
<tr>
<td>H.R. 622, to make permanent State and local sales tax deduction</td>
<td>-$42.4 billion</td>
</tr>
</tbody>
</table>
Global snapshot: many countries pursuing tax reform

► More than 40% of countries are engaged in significant tax reform activity

► Drivers include:
  ► Deficits
  ► Moves to increase competitiveness
  ► Responses to growing inequality
  ► Responses to changing capital flows

► Statutory corporate income tax rates declining
  ► Organisation for Economic Cooperation and Development (OECD) average dropped from 32.6% in 2000 to 25.2% in 2014
  ► Many countries deriving more revenue from consumption taxes

► Many countries moving to more territorial taxation systems
  ► Goal of attracting company headquarters
Global economic landscape has put pressure on governments

- Uneven global economic recovery
- High-debt levels continue despite recoveries in advanced economies
- Emerging markets adjusting to lower rates of economic growth
- High unemployment persists in some countries
- Sixteen of 19 G-20 countries ran a deficit in 2014 (according to IMF)
- Investors lack confidence that policymakers have tools to avoid future recession
- Outlook for global growth and inflation remains modest
Focus intensifying on companies’ taxes

► United States
► Scrutiny of companies’ tax dealings, including mergers and overseas reincorporations (‘inversions’)
► Calls for tax reform

► Globally
► State aid investigations
► New or strengthened general anti-avoidance rule (GAAR) proposals

► Organization for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project
OECD BEPS Action Plan

1) Tax challenges of digital economy - September 2014
2) Hybrid mismatch arrangements - September 2014
3) Controlled foreign corporation (CFC) rules - September 2015
4) Deductibility of interest and other financial payments - September/December 2015
5) Harmful tax practices - September 2014/September 2015/December 2015
6) Treaty abuse - September 2014
7) Artificial avoidance of permanent establishment status - September 2015
8) Transfer pricing for intangibles - September 2014/September 2015
9) Transfer pricing for risks and capital - September 2015
10) Transfer pricing for other high-risk transactions - September 2015
11) Development of data on BEPS and actions addressing it - September 2015
12) Disclosure of aggressive tax planning arrangements - September 2015
13) Transfer pricing documentation - September 2014
14) Effectiveness of treaty dispute resolution mechanisms - September 2015
15) Development of a multilateral instrument for amending bilateral tax treaties - September 2014/December 2015
Chairman Camp’s *Tax Reform Act of 2014* – corporate tax highlights

- Corporate tax rate lowered to 25% (five-year phase-in)
- Corporate AMT repealed – AMT credits refundable
- Major changes to corporate tax expenditures
  - Repeal accelerated depreciation for property placed in service after 2016 – +$270 billion/10 years
  - Research and experimentation (R&E) expenditures required to be amortized over five years – +$193 billion/10 years
  - Half of advertising expenditures amortized over 10 years, half deductible currently – +$169 billion/10 years
  - Phase-out section 199 manufacturing deduction – +$116 billion/10 years
  - Repeal LIFO – +$79.1 billion/10 years
  - Repeal tax-free like-kind exchanges – +$41 billion/10 years
Chairman Camp’s *Tax Reform Act of 2014* – corporate tax highlights continued

- **Research credit**
  - Modified alternative simplified credit (ASC) permanently extended equal to 15% of qualified research expenses for the year that exceed 50% of average of qualified expenses for preceding three years
  - Amounts paid for supplies or with respect to computer software would no longer qualify as qualified research expenses

- **Net operating losses** – Limit the deduction of an NOL carry-forward or carryback to 90% of a C corporation’s taxable income for the year. Would repeal certain special NOL carryback rules

- **Twenty-year amortization for goodwill and certain other intangible assets**
Chairman Camp’s *Tax Reform Act of 2014* – 
individual tax highlights

**Income tax rates:** 10%, 25% + 10% surtax on modified AGI in excess of $450,000 for joint returns ($400,000 for all others). AMT repealed.

**Capital gains, dividends:** Taxed as ordinary income, 40% excluded

**Major changes to tax expenditures:**

- **Personal exemptions:** repealed
- **Standard deduction:** increased to $22,000 for joint filers
- **Child tax credit:** increased to $1,500 and would be allowed for qualifying children under the age of 18
- **Mortgage interest:** Phase down from $1 million to $500,000 amount of mortgage indebtedness on which interest payments deductible
- **State and local tax deduction:** repealed
- **Charitable contribution deduction:** limited to contributions above 2% of adjusted gross income (AGI)
- **Tax-preferred retirement savings contributions:** limited, more savings pushed into Roth-type plans
Chairman Camp’s *Tax Reform Act of 2014* – computation of modified AGI for surtax

**Modified AGI includes:**

► The standard deduction
► All itemized deductions except the deduction for charitable contributions
► The foreign earned income exclusion (including the exclusions for income from Puerto Rico and US possessions)
► Tax-exempt interest
► Employer-provided health insurance
► Self-employed health insurance deduction
► HSA contribution deduction
► Untaxed Social Security benefits

**Excludes:**

► Qualified domestic manufacturing income (QDMI)
Chairman Camp’s Tax Reform Act of 2014 – International tax provisions

► Follows broad outlines of Chairman Camp’s 2011 discussion draft

► Establishes a new foreign dividend exemption system:
  ► Provides 95% deduction for dividends received from certain foreign subsidiaries
  ► Includes transition rule requiring deemed inclusion of deferred foreign earnings at two-tiered effective tax rate
    ► 8.75% for earnings invested in cash, cash equivalents and other short term assets
    ► 3.5% for other earnings

► Provisions aimed at prevention of base erosion
  ► Treats deemed intangible income as subpart F inclusion and makes deemed foreign intangible income subject to US tax at reduced rate of 15%
Chairman Camp’s *Tax Reform Act of 2014* – International tax provisions

- **Modifications to existing foreign tax credit (FTC) system:**
  - Repeals section 902 “deemed paid” FTCs
  - Provides non-pooled approach to section 960 FTCs
  - Modifies FTC to require reduction for directly allocable expenses only
  - Revises two-basket FTC system – mobile income and active income
  - Requires inventory sales income to be sourced based on place of production activities

- **Substantial reforms to existing subpart F anti-deferral regime:**
  - Provides new foreign effective tax rate thresholds for subpart F inclusions
  - Provides full or partial exclusion from foreign base company sales income based on eligibility for treaty benefits or foreign effective tax rate threshold
  - Extends active financing exception for five years but curtails availability based on foreign effective tax rate threshold
Chairman Camp’s *Tax Reform Act of 2014* – International tax provisions

- Provisions aimed at prevention of base erosion:
  - Treats deemed intangible income as subpart F inclusion and makes deemed foreign intangible income subject to US tax at reduced rate of 15%
  - Denies deductions for “excess” interest expense determined based on domestic leverage ratio exceeding 110% of worldwide leverage ratio and net interest expense exceeding 40% of adjusted taxable income

- Provisions affecting foreign investors:
  - Denies deductions for reinsurance premiums paid to an affiliate not subject to US tax on such premiums
  - Tax on income from operation of passenger cruise ships in US waters
  - Restricts availability of insurance business exception to the passive foreign investment company rules
  - Tightens section 163(j) earnings stripping rules by lowering net interest threshold to 40% of adjusted taxable income and eliminating excess limitation carryforward
  - Restricts treaty-based withholding tax reductions for deductible payments that are made by a US person to foreign related party
Questions
Acquisitions, dispositions and structuring

High Technology International Tax Symposium

25 March 2015
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Agenda

► Section 355 Spin-Off Transactions
  ► Overview
  ► Comparison to Section 301 Distributions
  ► Monetization Strategies
  ► Inversions
  ► Other Considerations

► Cash management
  ► Section 956 Environment
  ► Leveraged Distributions
  ► Notice 2014-32
  ► Notice 2012-39
  ► Section 901(m) and Notice 2014-44

► Attribute management
  ► Blended Basis
  ► E&P and FTCs
  ► Capital Loss Utilization
Spin-off transactions
Spin-off transactions – overview

Section 355 Distributions
- Allows “Distributing” to make a tax free distribution of “Controlled” shares
  - Statutory Requirements
    - Control
    - Active trade or business
    - Distribution of all “Controlled” stock, or an amount constituting “Control”
  - Not a device for distribution of E&P
- Judicial Requirements
  - Business purpose
  - Continuity of business enterprise
  - Continuity of interest
- May be a pro-rata “Spin-Off”, non-pro-rata “Split-Off” or “Split-Up”
Spin-off transactions - comparison to Section 301 Distributions

<table>
<thead>
<tr>
<th>Income/Gain</th>
<th>Section 301 Distribution</th>
<th>Section 355 Spin-Off</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Corporate level deemed sale treatment under Section 311(b)</td>
<td>Non-recognition treatment</td>
</tr>
<tr>
<td></td>
<td>Apply Treas. Reg. Section 1.301(c)(1) – (3) to determine tax treatment to Shareholders of distribution (dividend to extent of Distributing’s E&amp;P, reduction of Distributing’s stock basis, excess capital gain)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>For internal distributions within consolidated group-deferral triggered on external distribution</td>
<td></td>
</tr>
</tbody>
</table>

| Impact to Attributes | Gain on deemed sale of target shares | Treas. Reg. Section 1.312-10 impact |
|                     | Subpart-F | Treas. Reg. Section 1.367(b)-5 analysis |
|                     | Section 964(e) or Section 1248 | Shareholders’ tax basis in Controlled shares equal to a proportionate allocation of their tax basis in Distributing’s shares |
|                     | Shareholders’ tax basis in Controlled shares equal to fair market value of the shares |                          |

| Elective? | No, distributions that do not meet qualifications of Section 355 transactions are treated as Section 301 distributions | No, Section 301 distributions that meet qualifications of Section 355 transactions are treated as Section 355 transactions |
Spin-off transactions – monetization strategies

Generally, there are five ways Distributing can extract value in connection with a spin-off:

► **Liability assumption**: Controlled assumes a liability of Distributing as part of a Section 368(a)(1)(D) reorganization

► **Cash distribution**: Controlled distributes cash to Distributing as part of a Section 368(a)(1)(D) reorganization

► **Securities-for-debt exchange**: Distributing transfers Business B* to Controlled in exchange for Controlled stock and Controlled securities (i.e., long-term debt); Distributing repays “old and cold” Distributing debt with the Controlled securities and distributes the Distributing stock to its shareholders

► **Stock-for-debt exchange**: Distributing transfers Business B* to Controlled in exchange for Controlled stock; distributing uses up to 20% percent of the Controlled stock to repay “old and cold” debt and distributes the balance of the Controlled stock to its shareholders

► **Reverse spin-off**: Distributing borrows money, contributes the proceeds, along with Business A, to Spinco and then distributes the Controlled stock to its shareholders

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*Business B assets are those that Distributing will spin to Shareholders by the distribution of Controlled shares*
Spin-off transactions – monetization strategies (cont’d)

► Liability assumption and cash distribution are subject to
  ► A basis limitation – that is, for the assumption or distribution to be tax-free to Distributing, the amount of cash distributed/liabilities assumed cannot exceed Distributing’s basis in its Controlled stock (if Controlled is a preexisting subsidiary) or Distributing’s basis in the Business B assets (if Controlled is newly formed in connection with the transaction)
  ► Cash obtained in the first two methods also have limitations for usage (pay off debt, distribution to shareholders)
  ► The last three methods (securities-for-debt exchange, stock-for-debt exchange, reverse spin-off) generally are not subject to such a basis limitation
Note that cash distributed by Controlled in excess of tax basis may have gain implications.
Note that the Securities-for-Debt Exchange is often intermediated by an investment bank. In such a transaction, the bank purchases Distributing debt (e.g., commercial paper) on the open market. Then, after holding the debt as principal for its own account for five days, the bank may enter into an agreement to exchange the debt for Controlled securities nine days later. If the exchange is consummated, the bank generally sells the Controlled securities on the open market.
Spin-off transactions inversions (in general)

**Original structure**
- UST (Public)
- UST
- CFCs
- New FP
- MergerCo

**Steps**
- UST forms New FP. New FP forms MergerCo
- MergerCo merges with and into UST with UST surviving. In the merger, shares of UST are exchanged for shares of New FP

**Intended consequences / considerations**
- Single company inversion possible if New FP is incorporated in a country where the worldwide group has “substantial business activities”
- “Substantial business activities” exist in a foreign country only if at least 25% of each of the following is located in or derived from such foreign country
- If substantial business activities do not exist in the country of incorporation of New FP, New FP is treated as a US corporation for all purposes of the Code notwithstanding any other law or US treaty obligation

**Ending structure**
- UST (Public)
- New FP
- UST
- CFCs
Spin-off transactions – other considerations

- Continuing relationships and Tax Sharing Agreement
  - Impact to business purpose
  - Contingencies and reserves
  - Developing structure of IP rights between Distributing and Controlled
  - Go forward treasury strategies
  - Business infrastructure and systems

- State Issues – What’s tax free for federal purposes may not be for state
  - California does not conform with current active trade or business test (“SAG” rules)

- Carve-out Financial Statements
  - Day one balance sheet considerations

- Other acquisitions, dispositions and restructuring pre or post spin – Section 355(e)
  - Implications of pre-spin activity
  - Implications of post-spin activity
Cash management
Cash management – Section 956 Environment

► CCA 201420017
  ► Loan from partnership to a partner tripped Treas. Reg. Section 1.956-1T(b)(4)
  ► IRS also stated that the anti-abuse rule was concerned not with avoiding or reducing a Section 956 inclusion in general, but rather with avoiding the application of Section 956 to a particular CFC

► CCA 201446020
  ► Downstream loans from shared service center HoldCo CFC to lower tier CFCs tripped Treas. Reg. Section 1.956-1T(b)(4)
  ► Service’s position that the anti-abuse rule is concerned not with avoiding or reducing a Section 956 inclusion in general, but rather with avoiding the application of Section 956 to a particular CFC
  ► CCA offers additional insight into the factors IRS considers indicative of a principal purpose to avoid Section 956 under Treas. Reg. Section 1.956-1T(b)(4) in an arrangement involving back-to-back loans (including the potential foreign tax credit implications, as well as the amount of the Section 956 inclusion)
Cash management – CCA 201446020

Transaction
- On Date 1, CFC1 and CFC2 loaned initial loan amounts to CFC3, CFC4, CFC5, CFC6, and CFC7
- On the same day (or shortly thereafter), CFC3, CFC4, CFC5, CFC6 and CFC7 loaned substantially the same amounts to Taxpayer
  - Lower-tier CFCs have limited E&P
  - CFC1 and CFC2 have substantial E&P

Taxpayer Position
- Taxpayer treated the loans held by Lower-Tier CFCs as 956 property, limited to E&P of Lower-tier CFCs
- Taxpayer argued that the fact that CFC1 acted as shared service center for cash management constituted legitimate business purpose for the Loans
Cash management – CCA 201420017

▶ Transaction
▶ On Date 1:
  ► DE1 loaned Amount 1 to CFC Partner 1 (the FPS Loan)
  ► CFC 2 loaned Amount 2 to CFC Partner 1
  ► CFC Partner 1 loaned Amount 3 (the sum of Amount 1 and Amount 2) to US Parent (the CFC Partner 1 Loan)
▶ On Date 2:
  ► US Parent repaid the CFC Partner 1 Loan
  ► CFC Partner 1 repaid the FPS Loan to DE1

▶ Taxpayer Position
▶ The US corporation’s internal documentation concluded the anti-abuse rule should not apply because the partnership loan (from DE1) to CFC Partner 1 was intended to facilitate the application of Section 956, rather than avoid a Section 956 inclusion with respect to CFC Partner 1
  ► In other words, the anti-abuse rule did not apply because the partnership’s funding of CFC Partner 1 and its subsequent 956 loan in fact resulted in a Section 956 inclusion (albeit less than the amount of the 956 loan)
▶ US Parent included in gross income under section 951 the CFC Partner Loan 1 (i.e., Amount 3) as an investment in US property under Section 956
▶ Because the E&P of CFC Partner 1 was limited, that inclusion was less than the inclusion required had DE1 made its loan directly to the US corporation (rather than making it indirectly through CFC Partner 1)
Cash management – leveraged distributions

Step 1: OpCo loans $100 to Holdco
Step 2: Holdco distributes $100 to USP

Expected Treatment
- Tax-free return of basis (Section 301(c)(2))
- Consider *Falkoff v. Commissioner*

*Illinois Tool Works Inc. v. Commissioner*
- IRS challenging validity of HoldCo’s basis distribution
  a) Economic Substance
  b) Section 956 Anti-Abuse
- Currently in litigation

Budget Proposal
- President Obama’s 2016 budget proposal treats leveraged distributions as distributions from a lower-tier entity’s E&P
Current Law (Treas. Reg. Section 1.367(b)-10):

“Appropriate adjustments shall be made pursuant to this section if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of this section. For example, if S is created, organized, or funded to avoid the application of this section with respect to the earnings and profits of a corporation related (within the meaning of section 267(b)) to P or S, the earnings and profits of S will be deemed to include the earnings and profits of such related corporation for purposes of determining the consequences of the adjustments provided in this section, and appropriate corresponding adjustments will be made to account for the application of this section to the earnings and profits of such related corporation”

Notice indicates the regulation will be modified to clarify the following:

- S’s acquisition of P stock or securities for a note may invoke the anti-abuse rule
- E&P of another corporation may be taken into account for purposes of determining the consequences of the adjustments in the regulations (e.g. the deemed distribution) regardless of whether such corporation is related to P or S before the reorganization
  - Can T’s E&P be taken into account?
- Funding of S may occur after the reorganization
- A funding may include capital contributions, loans and distributions
Treas. Reg. Section 1.367(b)-10 before and after the notice:

Treas. Reg. Section 1.367(b)-10 before the Notice:

► CFC HoldCo is deemed to distribute $1,000 to USP ($900 return of basis and $100 dividend)
► USP is deemed to contribute $1,000 of property to CFC HoldCo
► USP’s basis in CFC HoldCo is increased by $1,000
► USS recognizes no gain with respect to its Target CFC stock (assuming Gain Recognition Agreement (GRA) is filed)

Treas. Reg. Section 1.367(b)-10 as modified by the Notice:

► CFC HoldCo is deemed to distribute $1,000 to USP ($900 return of basis and $100 dividend)
► USP’s basis in CFC HoldCo is increased by $500 (equal to USS’s basis in Target CFC) under Treas. Reg. Section 1.358-6
► USS recognizes no gain with respect to its Target CFC stock (assuming GRA is filed)
► Application of anti-abuse rule as clarified?
PTI Example

► Application of the revised coordination rule
► Treas. Reg. Section 1.367(b)-10 is not applicable if the Section 367(a) gain recognized is equal to or greater than the Section 367(b) income (which is subject to US tax)
  ► Section 367(a) gain = 0 (assuming GRA is filed)
  ► Section 367(b) income = 0 (because a PTI distribution is not treated as a dividend under Section 959(d) and because the distribution does not otherwise trigger US tax)
  ► Consider disparity in state tax from federal tax treatment
  ► Thus, Treas. Reg. Section 1.367(b)-10 ought not apply, and the PTI is not treated as distributed
► Anti-abuse rule?
  ► What if prior step was a distribution of the $1,000 PTI from Existing CFC?
  ► Is it relevant that section 959(c) mandates that PTI is always distributed first?
Summary of Notice 2012-39

- The IRS believes taxpayers have engaged in certain outbound reorganization transactions that result in the improper repatriation or use of foreign cash.
- The notice describes regulations to be issued, effective 13 July 2012, applicable to such reorganizations that will require immediate income recognition with respect to transferred IP.
- The notice provides two distinct rules for the recognition of income or gain with respect to transferred IP:
  - In an outbound reorganization, the US transferor will recognize gain on its IP if it has any shareholders that are not domestic corporations (i.e., a shareholder that is not a qualified successor).
  - In an outbound reorganization with boot (or the assumption of certain liabilities), the US transferor (or its qualified successor) will treat the boot as a prepayment of the deemed royalty due pursuant to Section 367(d).
## Application of Notice 2012–39

<table>
<thead>
<tr>
<th>CFC purchaser with outbound F</th>
<th>US purchaser with outbound cash D</th>
<th>US purchaser with leveraged outbound F</th>
</tr>
</thead>
<tbody>
<tr>
<td>USP</td>
<td>USP</td>
<td>USP</td>
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<tr>
<td>CFC NewCo</td>
<td>Existing CFC</td>
<td>CFC NewCo</td>
</tr>
<tr>
<td>US Target</td>
<td>Outbound</td>
<td>Outbound</td>
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<td>Outbound</td>
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</tr>
</tbody>
</table>

- CFC not a qualified successor
- US Target recognized gain on all IP
- Receipt of boot treated as a prepayment of deemed royalty under Section 367(d)
- Assumption of liability treated as prepayment of deemed royalty under Section 367(d)
Year 1
- USP purchases stock of US Target
- US Target reorganized as foreign company in an outbound F (CFC NewCo):
  - Gain on tangible assets
  - Section 367(d) on IP

Year 2
- CFC NewCo pays dividend in the form of a note:
  - 80% dividends received deduction (DRD) to the extent of US E&P
  - Return of capital
- CFC NewCo acquires CFC HoldCo in an asset reorganization under Section 368(a)(1):
  - Not subject to Notice because USP is a qualified successor, and there is no boot
  - Consider alternatives for monetizing the note or basis
The Notice expresses concerns with taxpayers’ interpretation of the statutory disposition rule. In cases where no gain or loss is recognized for either US or foreign income tax purposes, the Notice explains that Section 901(m) should continue to apply.

**Example of targeted transaction**

- CFC acquired FT in a qualified stock purchase, followed by a Section 338(g) election. FT’s assets are Relevant Foreign Assets.
- FT makes a CTB election.
- Taxpayer takes the position that the deemed liquidation constitutes a disposition of the relevant foreign assets for purposes of the Statutory Disposition Rule (Section 901(m)(3)(B)(ii)) and therefore all of the basis difference is allocated to the final taxable year of FT by reason of the deemed liquidation.
- The deemed liquidation is also a Covered Asset Acquisition (CAA), but basis difference that arises to this subsequent covered asset acquisition generally would be minimal (e.g., ordinary market value fluctuations vs. basis step-ups).
Attribute management
Outbound property transfer obtaining blended basis

Transaction:
- **Step 1:** Holdings forms Transferee
- **Step 2:** Holdings transfers Target CFCs to Transferee for voting and nonvoting stock

Intended tax consequences:
- Each share of Transferee stock has an identical, averaged basis; See Treas. Reg. Section 1.358-2(b)(2)
- See *e.g.*, PLRs 201150021, 201043021; cf. Rev. Rul. 85-164
E&P reduction through stock distribution

**Step 1:**
FS2 redeems 90 of the preferred shares in a 302(d) redemption.

**Step 2:**
FS1 distributes the FS2 stock to USP.

**Proposal** – Following Step 2, FS1’s E&P would be reduced by $10 and would now be $80.

**Note:** For a similar basis shifting result in a consolidated return context, see PLR 9815050 (9 January 1998) and PLR 200810015 (4 December 2007).
Assume FS1 makes a $100 distribution of cash to USP.

- **Section 301(c)(2) return of basis** = $10
- **Section 301(c)(3) deemed sale treatment of FS1 Shares Result**
  - Deemed Section 1248 dividend = $40
  - Capital Gain on Deemed FS1 Stock Sales = $50

**Intended consequences and considerations**

- USP recognizes $40 of ordinary income and $50 of capital gain
- USP utilizes Capital Loss Carryforward, which may have expired otherwise
- $40 of Section 959(e) PTI at FS2 due to Section 1248 Inclusion
  - No Section 961(a) basis in this PTI
Questions
Break
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India – Changing paradigm
Government approach to tax policy

► Intent to foster a stable and non-adversarial tax regime
► Instructions issued to Revenue authorities to implement a series of taxpayer friendly measures such as:
  ► Non-filing of frivolous appeals
  ► Improvement in quality of audits
  ► Addressing taxpayers complaints
  ► Restricting scope of scrutiny
► Government decided not to appeal Bombay High Court ruling in the case of Shell and Vodafone on the share valuation matter
India – Changing paradigm
Government approach to tax policy

 ► Tax Administration Reform Commission constituted to:
   ► Review application of tax policies and tax laws in context of global best practices
   ► Recommend measures for reforms required in tax administration to enhance its effectiveness and efficiency

 ► Strengthening of dispute resolution mechanism
   ► Additional resources allocated to Advance Pricing Agreement (APA) team
   ► Reconstitution of dispute resolution panel
   ► Authority for advance ruling
     ► Facility of advance ruling extended to resident taxpayers, subject to threshold limits
     ► Additional benches for speedy disposal of cases
Withholding taxes on royalty/ FTS payments to non-residents reverts back to 10% from 25%

Proposal to reduce rate of corporate tax from 30% to 25% over the next four years, starting from next year

General Anti-Avoidance Rules (GAAR) deferred by two years (i.e., applicable from 1 April 2017)
  - Grandfathering benefits extended to investments made until 31 March 2017

Strong indication to introduce Goods and Services Tax by 1 April 2016

Service tax on ‘aggregator’
India – Service tax on aggregator

- Definition
- Effective date – 1 March 2015
- Taxable value – gross receipts/service fee or both?
- Manner of discharging service tax obligation
- Input tax credit may pile up with no opportunity to set-off
- E-commerce businesses that could be impacted
  - Marketplace portals
  - Cab/radio taxi aggregators
  - Travel/food portals
  - Space sharing portals
  - Matrimonial portals
  - Online-education apps

Aggregator liable to pay service tax (can collect from the customer)

Aggregates services of various service providers
Provide service to customer under brand name
China – VAT reform continues in 2015
Impact on e-commerce service sector

Operation model illustration

- Taxable value – gross receipts
- Applicable VAT rates
- VAT compliance procedure
- Utilize input VAT credit
- Foreign exchange policies

E-commerce company (US)

Local supplier (CN)

Consumers (CN)

Provision of service

Cash flow

Outside of China

China

$$

$$
India – Union Budget 2015
Key tax proposals impacting technology sector

- Clarification on indirect transfers
  - Substantiality threshold – at least 50% of value derived from India
  - Computation of capital gains to be based on FMV as may be prescribed under rules
  - Taxation on proportionate basis
  - Exemption
    - Foreign amalgamations and demergers, subject to certain conditions
    - Small shareholders – 5% of voting power/share capital
  - Reporting obligation on Indian concern
China – SAT Notice [2015] No. 7
Key changes in the indirect transfer rules

- **Circular 698**
  - In form of SAT responses to inquiries by local tax bureau
  - High uncertainty for taxpayer
  - Frequently inconsistent tax positions
  - High workload for tax administration

- **Notice 7**
  - In form of SAT announcement (increased level of authority)
  - Expanded scope and more details in guidance
  - Shifting pressure onto taxpayer’s self-assessment
  - Improved effectiveness of tax administration

- **Exempted Transactions**
  - In-scope indirect transfer transactions
    - Mandatory reporting
    - GAAR review for business purpose and commercial substance
- **In-scope indirect transfer transactions**
  - Deemed taxable transactions
  - Safe harbor for qualifying group restructuring
  - Further analysis
## Key changes in the indirect transfer rules

### Safe harbor for qualifying group restructuring

- **Ownership test**
  - At least 80% shareholding, directly or indirectly for
    - Transferor (parent) and transferee (sub)
    - Transferor (sub) and transferee (parent)
    - Transferor and transferee under the same parent
  - China tax liability not reduced; and
  - 100% equity consideration

### Deemed taxable transactions

- **Value/income sourced from China**
  - Value (≥ 75%) of the offshore entity’s equity
  - Value of assets or income generated (≥ 90%) of the offshore entity
- **Functions and risks of the transferee and its subsidiaries commensurate their economic substance; and**
- **Overseas tax burden of the transaction lower than the possible China tax**
China – SAT Notice [2015] No. 7
Key changes in the indirect transfer rules

**Before the restructuring**

- **Parent Co**
  - **HoldCo 1**
    - **Opt Co 1** (Business A)
    - **Opt Co 2** (Business A)
  - **Hold Co 3** (Business B)
  - **Opt Co 3** (Business B)

**After the restructuring**

- **Parent Co**
  - **HoldCo 1**
    - **Opt Co 1** (Business A)
    - **Opt Co 2** (Business B)
  - **Hold Co 3** (Business B)
  - **Opt Co 3** (Business B)
BEPS
Where does China stand?

Action 1: Address the challenges of the digital economy

Action 2: Neutralise the hybrid arrangements
Action 3: Strengthen CFC rules
Action 4: Limit base erosion via interest deductions and other financial payments
Action 5: Counter harmful tax practice more effectively, taking into account transparency and substance
Action 6: Prevent treaty abuse
Action 7: Prevent the artificial avoidance of permanent establishment status

Action 8: Consider transfer pricing for intangibles
Action 9: Consider transfer pricing for risks and capital
Action 10: Consider transfer pricing for other high-risk transactions
Action 11: Establish methodologies to collect and analyse data on BEPS and actions addressing it
Action 12: Require taxpayers to disclose aggressive tax planning arrangements
Action 13: Re-examine transfer pricing documentation
Action 14: Making dispute resolution more effective
Action 15: Develop of a multilateral instrument for amending bilateral tax treaties
BEPS
India’s position impacting technology industry

► Action 1 – Addressing tax challenges of digital economy
  ► No specific provisions concerning digital economy present
  ► Domestic tax law definition of royalty/FTS broad enough to capture many digital economy transactions
  ► Expanded definition of place of business (for registration and corporate law compliance purposes) to include operations conducted via an ‘electronic mode’ under corporate law

► Action 7 – Prevent artificial avoidance of PE status
  ► Low threshold for PE definition - provision regarding agency PE and service PE
  ► Delivery related exclusion from PE test/occasional delivery
  ► Review of exemption for preparatory or auxiliary activities
BEPS
India’s position impacting technology industry

► Action 13 – Country by country (CBC) reporting
  ► CBC reporting not to be implemented before agreed date
  ► CBC to be used as risk assessment tool and will not be basis for audits/not to be used for application of global apportionment methods
China – Tax Collection and Administration
Key changes in the amended Law (Draft)

► Key elements
  ► Enhance the administration system to protect taxpayer rights
    ► Advance Ruling Mechanism
    ► Improve the mechanism for filing amended returns, extension and payment by installments
    ► Introduce a scheme to allow late payment interest and penalties relief
    ► In cases of disputes, eliminate the current “settle the tax in dispute first” criteria prior to initiating a Tax Administrative Review (TAR)
  ► Enhancements to the tax administration system
    ► Statute of Limitation provisions
    ► Enhance tax authorities’ power to obtain information
    ► Alignment with other legislation (e.g., criminal law)
  ► Timetable to finalization
Questions
Managing tax controversy and dispute resolutions

“Predict success, not audit lotteries or tax legislation”

High Technology International Tax Symposium

25 March 2015
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Introduction

► Managing controversy is the Keystone of tax planning
► Controversy begins as a reaction to WWETR < 35-40%
  ► Transfer Pricing, APB 23, Tax Holidays, No PE, No WHT, Nontaxable exchanges, FTC, etc.
  ► Phases: Losses, Deferral, (Non)Taxable Repat, M&A, etc.
► Increased attention from media and stakeholders
► Internal expectations to “Get It Right” while staying ahead of business, M&A, US GAAP/Tax developments, etc.
► Increased information sharing among tax authorities will likely lead to selective interpretation
► Essential to create a great first and lasting impression
Managing International Tax Controversy –
Factors impacting your decisions …

► Consider the applicable worldwide tax regimes, and “anticipate the tax risks” and potential for controversy

► Prepare for heightened contemporaneous documentation expectations – how well does the file “support the story”

► Be aware of new information sharing and increased levels of government to government transparency and disclosure

► Don’t underestimate the potential for the IRS to extrapolate unfavorable tax positions and resulting conclusions

► Understand the landscape for your tax issues, likelihood of prevailing, existing law, rulings, decisions, Appeals
Steps taken by IRS LB&I to bolster international tax administration and compliance monitoring

► Implementation of the new IDR Enforcement Directives – coincides with new Appeals rules on case return procedures
► Required fully documented factual development and acknowledgement of the facts by the taxpayer – particularly if there are tax issue disputes
► International structure around transactions and issues – with a dedicated framework for transfer pricing
► Development of International Practice Networks and International Practice Units – consistent expectation for treatment of issues
► Encouraged use of issue resolution strategies, such as Fast Track Settlement, APAs, Pre-filing Agreements, PLRs
► Expected discussions about exit strategies to address the future tax treatment of issues to eliminate carryover and recurring issues
IRS LB&I – Deputy Commissioner International

Office comprised of…

► Exchange of Information
► Overseas Operations – (Foreign Posts – Closing)
► International Business Compliance
► Foreign Payments Practice
► International Data Management
► International Practice Networks
► International Individual Compliance
► Central Withholding Agreement
► Offshore and Non-Resident Compliance
► Transfer Pricing Operations
► APMA and Transfer Pricing Practice
International Matrix – foundation for the LB&I Integrated International Program

Matrix

- **BUSINESS OUTBOUND**
  - Income shifting
  - Deferral planning
  - FTC management
  - Repatriation

- **BUSINESS INBOUND**
  - Jurisdiction to tax
  - Income shifting
  - Inbound financing
  - Repatriation/Withholding

- **INDIVIDUAL OUTBOUND**
  - US business activities
  - Withholding

- **INDIVIDUAL INBOUND**
  - Treaties
  - Information gathering
  - Foreign currency
  - Organization/Restructuring

Key Concepts:
- **Income shifting**
- **Deferral planning**
- **FTC management**
- **Repatriation**
- **Jurisdiction to tax**
- **Income shifting**
- **Inbound financing**
- **Repatriation/Withholding**
- **US business activities**
- **Withholding**
- **Treaties**
- **Information gathering**
- **Foreign currency**
- **Organization/Restructuring**

Tax Strategies:
- **Income shifting**
- **Deferral planning**
- **FTC management**
- **Repatriation**

Jurisdictional Considerations:
- **Jurisdiction to tax**
- **Income shifting**
- **Inbound financing**
- **Repatriation/Withholding**

Financial Arrangements:
- **US business activities**
- **Withholding**
- **Treaties**
- **Information gathering**
- **Foreign currency**
- **Organization/Restructuring**
# IRS LB&I International Practice Networks

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<th>International Practice Networks (IPNs)</th>
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<td>Business outbound</td>
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<td>Income Shifting Outbound (TPO)</td>
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<td>Deferral planning</td>
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<td>FTC Management</td>
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<td>Repatriation</td>
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# IRS LB&I Transfer Pricing Audit Roadmap

## QEP Phases

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<tr>
<th>Planning</th>
<th>Execution</th>
<th>Resolution</th>
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## Transfer Pricing Audit Stages and Timeline

### Cycle Time in Months

| Non-cycle time | 1st to 2nd | 3rd | 4th | 5th | 6th | 7th to 15th | 16th | 17th | 18th | 19th | 20th to 23rd | 24th |

### Pre-Examination Analysis

| Opening Conference, Transfer Pricing Orientation |

### Mid Cycle Risk Assessment

| Preliminary Reports and Findings |

### Pre-NOPA Issue Presentation

| Pre-NOPA Discussion |

### Final NOPA and Case Closing
Managing International Tax Controversy –
Steps for assessment and readiness …

► Develop (business purpose) presentations for high risk/high dollar issues that can be readily updated and shared with reviewing tax administrations

► Be proactive during the factual development of issues under examination, as well as during the legal analysis and the issue resolution phases

► Be mindful of possible collateral issues such as those impacting FTC determinations: changes in E&P, shifting income/expenses

► Consider pre-filing alternative resolutions available, including APAs (APMA), Pre-Filing Agreements (PFA)

► Understand available post-filing issue resolution options and stage them accordingly; draft NOPA meetings, elevation within the chain of command, Fast Track Settlement, Accelerated Issue Resolution (AIR), traditional Appeals, Post Appeals Mediation
Managing transfer pricing controversy –
*Trends*

- Increasing information sharing among tax authorities
- Increasing expectations of transparency across entire supply chain
- New disclosure requirements
  - Profits accruing to each entity along the value chain
  - Contribution to value creation by each entity
  - APAs and rulings
- Increased transparency and disclosure leading to improved targeting for tax audits
- Decreasing tolerance among tax authorities for one-sided transfer pricing methods
- Views on substance and value creation trending towards presumption that they are people-driven only
Managing transfer pricing controversy –
*With enhanced transfer pricing documentation*

► Master file and CbC reporting requirements represent additional disclosure and extra effort to comply
► Why not let the extra effort yield a benefit through putting your transfer pricing transactions in the right context?
► Plan to address the trends: be proactive and engage with the business
Managing transfer pricing controversy –

*Drivers of enhanced documentation*

- Deferral structures
- IP migration – either internally developed or acquired intangibles
- Entities in market countries are routine service providers
- Significant percentage of overall profits in a “low substance” entity
- Recent conversion from a “full-risk” to a more limited risk entity
- Disconnect between contract and operational reality – e.g. service provider contracted by one related entity, but the employees organizationally report to a different entity
Managing transfer pricing controversy –
Organizing your response

- **Prior year(s):** Year is closed and return is filed – limited flexibility, but some remediation/clean-up is possible

- **Current year:** Year is closed, return not filed – transactions are set, but many issues can be addressed more effectively through enhanced TP documentation

- **Future:** Maximum flexibility to adjust to changing landscape
Prior years –
*Is there anything to clean up?*

- Look again at prior year documentation through the lens of BEPS
- Is something under-explained such that a tax authority could create their own (unfavorable) interpretation?
- Do you care to do anything now to improve the factual development around that issue?
- You can’t change your facts, but it may make sense to gather and document additional facts in anticipation of controversy
Current documentation – Stay the course or anticipate change?

► Review existing documentation in context of BEPS Actions 8-10
  ► Take any opportunity to refute potential profit-split or recharacterization assertions by tax authorities
  ► Consider identifying and explaining your alternatives to having employees in-country – such as outsourcing to a third-party service provider
► Consider adding elements of Action 13 requirements now
Future documentation –
How much should you change, and how fast?

► All options are potentially on the table – the transactions have not taken place yet.
► Do you have the right structure and TP policy? For where your company is now? For where your company will be in several years?
► Is your TP policy accurately reflected in your financial results?
► Does your TP documentation adequately explain why each entity in the value chain receives its return?
► Do you have a centralized view of what you are telling the tax authorities around the world?
► How quickly to converge transfer pricing documentation to the new Action 13 standards?
► Are you ready for tax authorities to view your CbC report info?
Managing transfer pricing controversy – APAs and rulings

- Process for deciding on whether to go for an APA or ruling has not changed
- Some key-drivers within that process (local TP risk profile, for example) probably have changed or will
- Treasury appears to be pushing more “traditional” views of transfer pricing within the BEPS process, in certain fact patterns this could be leveraged via a Bilateral APA
- Impact of thawing US-India relationship on overall APMA caseload?
- 2013 APMA Annual Report – positive trends with record number of cases closed and decreasing processing times
Collateral consequences of foreign transfer pricing adjustments

► Increased scrutiny by foreign tax authorities in examining transfer pricing methodologies
  ► Current focus on value chain and functions performed in local country.
  ► Notwithstanding the existence of arm’s length remuneration to local support subsidiary, the foreign principal may still be subject to permanent establishment (PE) assertion(s)
► Foreign audit could result in additional foreign income tax assessment
  ► Treas. Reg. § 1.901-2 allows a credit against U.S. income tax for "any income, war profits and excess profits tax paid or accrued ... to any foreign country or to any possession of the United States"
  ► Sec. 903 allows a credit for a "tax paid in lieu of a tax on income ... otherwise generally imposed by any foreign country or by any possession of the United States"
Collateral consequences of foreign transfer pricing adjustments (cont’d)

► Consideration for creditability of the foreign tax
  ► Whether the foreign levy is a “tax” where the predominant character is that of an income tax in the US sense
    ► The foreign levy is a tax if it requires a compulsory payment.
    ► Penalties, fines and interest do not qualify as a “tax”
  ► If the foreign levy is a tax, whether it is a separate tax to which the creditability criteria of Sec. 901 or Sec. 903 (in lieu of income tax) will be applied
  ► Whether the taxing authority is considered a foreign country or US possession
  ► Whether the person claiming the credit is the “taxpayer” with respect to the foreign tax
  ► The amount of creditable foreign tax that is paid or accrued
Developments on compulsory payments

- CCA201349015 –§§ 482 & 901 on transactions with foreign branches/disregarded entities
  - Addresses the proper standard for determining the compulsory amount of creditable foreign taxes imposed with respect to transactions between
    - i) US corporation and its foreign disregarded entity;
    - ii) CFC and its foreign disregarded entity
  - US transfer pricing principles may be relevant in determining whether non-arm’s length transfer prices resulted in non-compulsory payments of foreign tax, and thus not eligible for FTC
  - Concern is that non-arm’s length pricing causes the foreign disregarded entity to report too much income to the foreign jurisdiction resulting in an overpayment of foreign income tax
Illustration

Facts:
- US 1 wholly owns CFC1
- Country B tax authority assesses additional transfer pricing income
Illustration

Before

► Result:
  ► Increased ETR for CFC1 due to additional tax assessment
  ► Tax trapped in CFC1 until earnings are repatriated, or deemed inclusion under Subpart F rules
  ► Further dilution of taxes in a low-tax E&P pool

After

► Result if properly managed:
  ► No increased ETR for CFC1
    ► Additional taxes from assessment attributed to New Holdco CFC
    ► In year of formation of New Holdco, consider the impact of Treas. Reg. § 1.901-2(f)(3) requiring the allocation of income taxes
  ► Services income will be treated as subpart F income to the extent of current year E&P
  ► No dilution of taxes in a low-tax E&P pool
Managing controversy

► Identify, test and support key WW tax assertions
  ► Revenue (signoff processes for internal v. external confirms)
  ► Loans/Advances, Intangible Development Costs, Zero E&P
  ► Substantial Contribution, Reg. §1.861-18, -7 CSA, etc.
  ► Significant transactions (e.g., Onshoring/Integrating IP, PCTs)
  ► US Tax Reporting Objectives, including §6501(c)(8)
  ► Due diligence procedures (Triage)
► Special evaluations for Hybrid Debt, Commissionaires
► CbC Reporting will attract more attention
► What are key measures (US GAAP vs. Non-GAAP) for tax?
  ► Mechanical (Volatile?) v. Insightful
► Expect more attention from media and watchdogs
► Resources to monitor and avoid key legislative threats
Concluding remarks

► Tax authorities proposing large adjustments often without developing facts
  ► BEPS early adoption, Cloud models, etc.
  ► Develop and test key controls: Rev Rec, Internal Approval, etc.
► Greater transparency will likely lead to misunderstanding; some overkill on Initial CbC Report probably helpful
► Give full consideration to all of the following:
  ► Tax must be part of making business decisions
  ► CbC Reporting (Compliant, Consistent, Compelling, yet “Boring”)
  ► Dispute Resolution Tools
  ► Clear external messaging aligned with “As Filed” Position
  ► Monitor US legislative and regulatory threats; prepare to move fast
► Preparation is key to successfully managing controversy
Questions
Thank you for attending