

# Minnesota Association for Financial Professionals Presents:

## *Tax Best Practices for Effective Global Treasury Management*

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Presented By:

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# Presenters



*Doug Watson*

- Doug has focused the past 32 years on assisting multinational clients on international tax matters, including cross-border mergers and acquisitions, reorganizations and structured finance. Doug started his career at Arthur Andersen assisting U.S.A. Multinational Corporations expand into non-U.S.A. markets.

- Doug joined Grant Thornton in 2014 after retiring from a 19 year career in various tax leadership positions at Accenture. While at Accenture, Doug helped start and grow the internal tax function in 1995 from 5 tax professionals to a world class tax function of 120 people on the date he retired. Some of the global projects Doug led at Accenture included global cash repatriation and legal entity optimization.



*Danny Johnson*

- Danny has been with Grant Thornton for over 2 years and has experience with international and corporate tax compliance. Danny has also assisted in various projects including supply chain optimization, and international reorganizations.

# Agenda

1. Effective Global Treasury Management: A Partnership between Treasury, Finance, Legal, and Tax to Deliver High-Value to your Company
2. The Current Tax Environment Impacting Effective Treasury Management
3. Essential Tax Considerations Affecting Global Treasury Management
4. Global Treasury Management Tax Best Practices
5. Questions



# Have you had this discussion at your Company today?

## 8:00 AM **CEO/CFO** of US MNC to **Treasurer**

*We need our non US cash to fund dividends, share buy backs, US CAPEX, R&D, M&A*

## 9:00AM **Treasurer** to **VP Tax**

- *I want my non USA cash!*
- *How do I get my cash?*
- *When can I get my cash?*
- *What is the cost to get my cash:*
  - *Cash tax?*
  - *ETR/ EPS hit?*
  - *FX Cost?*

## 9:05AM **VP Tax** to **Treasurer**

- *Remember we have a APB23 Assertion on some of our foreign earnings, We can not get the cash without a ETR/EPS impact*
- *Our options are limited but lets start with the countries with no APB23 assertion*

**Pop Question: Who else wants your cash?**

*Tip: The T\_X C\_LL\_CT\_R from **all** countries you do business in!*

# Challenges of a Multi-National Company Best-In-Class Treasury Function

As financial stakes increase and decisions become more complex, cash and treasury management solutions must succeed as planned the first time. **Key levers to success:**

- **Optimize processes**, manage risks, strengthen controls and provide support relevant to the business.
- **Integrate, automate** and use new technology, centralized/standardized processes to achieve timely and accurate forecasting.
- **Define metrics** & reporting to produce accurate timely reports, take action and avoid operational errors.
- **Effective treasury global strategies** that provide improved visibility/transparency and access to optimized liquidity and more comprehensive risk management. Drive high performance.
- **Cash and Liquidity management**: cash position, cash forecasting, bank relationships, payment and debt management.
- **Corporate strategy**: linked to financial strategy, appetite for risk, policy and controls.
- **Move from decentralized to centralization** of treasury management.
- **MNC cash needs**: dividends and share buy backs; pay off debt; fund research and development; develop new businesses and new markets; fund CAPEX and M&A.
- **Operating in multiple countries** the movement of cash can be complex and if not appropriately designed can result in the inefficient and costly repatriation of cash.
- **End game**: complete visibility into financial positions and risks so that treasury organizations can make intelligent business decisions to achieve strategic financial goals.

**MNC treasury requires a tax driven focus in order to set up the most effective structure for managing liquidity and risk and cash repatriation worldwide.....**

# The Importance of Effective Global Treasury Management

## Potential Negative/Positive Cash Flow Impact of Taxes:

- Corporate income tax (i.e. rates can range from 10-35%)
- Withholding taxes on intercompany transactions, such as interest, royalties, and dividends (i.e. rates can range from 0%-30%)
- Indirect taxes (i.e. rates can range from 0%-27%: ex. sales use tax, value-added tax)
- Transfer Pricing for intercompany transactions determines which legal entity has profit and related cash and may impact the amount of customs duty paid
- Tax Audits may require additional tax payments

## Liquidity

- Depending on the country, ability to declare and pay dividend and or do share buy-back will impact movement of cash
- Royalty and debt provide opportunity to move cash more freely depending on the country
- Tax planning can devise an approach to facilitate movement of cash in a tax efficient manner

# The Current Tax Environment Impacting Effective Treasury Management:

- Cash Repatriation
- US Tax Reform
- UK Tax Strategy Publication
- Brexit
- EU Directive

# The Environment Impacting Cash Repatriation

- Governments have need for more tax revenue; **Who wants your cash?**
  - *Italy Tries Bite At Apple As Authorities Investigate Tax Transactions*, *Forbes* 11/15/2013
  - *The Non Existent Irish Tax Loophole Being used By Mircosoft, Linked in, Twitter, Apple, Uncle Tom Cobbleign*, *Forbes* 10/28/2013
  - *Caterpillar Bulldozes Tax Code Like Apple, Google and Facebook* , *Forbes* 4/1/2014
  - *The British Want to Stop Starbucks from Dodging Taxes It Won't work*, *The Washington Post* 4/18/2013
  - *Tax Avoidance: Are Starbucks and Amazon Playing the System*, 4/24/2014
  - *Apple Pays No tax On Much of its Overseas Income Senate Panel*, *Wall Street Journal* 5/20/2013





# Government Focus on Transfer Pricing and Earnings Stripping: More Difficult to Repatriate Cash!

- **Earnings stripping (Base Erosion and Profit Shifting [BEPS])**  
MNC reduces its overall tax liability by moving earnings from typically a relatively high-tax jurisdiction to a low-tax jurisdiction through payment of interest royalties etc.
- **High** media attention has increased **governments focus on** BEPS and the perceived international tax avoidance techniques of high-profile MNC,
- Organization for Economic Cooperation and Development (OECD) has issued action plan to address **perceived flaws in international tax rules**:
- 15 separate action points including:
  - Broad definition of intangibles
  - Country by country reporting of income
  - Transfer Pricing Risk Assessment Handbook
- **Will countries wait for BEPS report or enact legislation to attack BEPS with result that taxpayers are subject to inconsistent global treatment?**

# EPS Challenge: What exactly is APB23?

- **Hot topic for the SEC:** SEC is reviewing APB23 assertions of MNC!
- US earnings are generally not subject to US tax until earnings are repatriated (i.e. deferral concept) but US GAAP requires taxes to be assessed for book purposes as if currently distributed.
- **APB23** provides an exception to the requirement to recognize deferred taxes on undistributed earnings of foreign subsidiaries if the related undistributed earnings are or will be indefinitely invested (**PRE**) in the foreign entity. Examples:
  - Foreign acquisition or Geo expansion
  - Investment in foreign R&D
  - Retirement foreign debt
  - CAPEX in foreign locations
  - Payment intercompany charges
- Assessment is a bottom up approach by reviewing the relationship with the investee's immediate investor.
- A partial APB23 assertion maybe possible.

How does APB23 impact your cash repatriation strategy????

# Current Environment: Foreign Tax Reserves are 'crack cocaine' for Earnings Manipulation

- The accounting standard in question, known as **APB 23**, was criticized in a Sept. 20 Senate hearing chaired by Sen. Carl Levin of Michigan. Witness Jack T. Ciesielski, president R.G. Associates, called PRE “a malleable pool of earnings to be sliced as finely as needed to meet earnings estimates with pinpoint precision.” The Accounting Association said a tax director of a Fortune 500 company has **compared it to crack cocaine, saying that “once you start using it, it’s hard to stop.”** [Forbes.com \(October 25, 2012\)](#)

**"Once you start using it, it's hard to stop..."**

Over \$2.5 trillion of PRE of the Russell 1000 with average annual increase of \$204 billion during last 5 years (93% growth)

Year	# of Firms with an Accumulated IRE Balance	Total Foreign Indefinitely Reinvested Earnings (Billions)	Year-to-Year Change in Total Foreign IRE	Total Assets For Firms With an IRE Balance (Billions)	Total IRE As a % of Total Assets
2013	547	\$2,119.30	12.45%	\$24,320.77	8.71%
2012	533	\$1,884.62	15.76%	\$23,223.97	8.11%
2011	516	\$1,628.03	19.52%	\$21,590.54	7.54%
2010	491	\$1,362.15	14.70%	\$20,567.44	6.62%
2009	472	\$1,187.61	8.11%	\$18,753.47	6.33%
2008	487	\$1,098.47		\$18,935.52	5.80%

# What are APB23-elected companies doing to get non-US cash?

- Hope Congress will enact legislation similar to 2006 which permits MNC to return foreign earnings at a preferential tax rate?
- Pay down intercompany payables
- Insert debt and pay interest or principal
- Planning to create return of basis opportunities
- Short Term Borrowings from Foreign Subsidiaries with cash **And** structured to avoid triggering deemed dividend under IRS 956 Ex. HP
- Borrow in USA and pledge 66% or less of stock of foreign subsidiary **to avoid** triggering deemed dividend under IRS 956
- **Access** global bond markets taking advantage of low interest rates Ex. Apple, Microsoft
- **Corporate Inversions** Ex. AbbVie, Medtronic, Walgreens

# Heart of the Debate: The US MNC Tax Deferral Concept

- Branch earnings are taxed in the USA on a current basis whether earnings are distributed or not.
- CFC earnings are not taxed in the USA until either an actual dividend or a deemed dividend occurs
- **Example:**
  - Irish subsidiary earns \$100 and pays 12.5% Irish tax. Result is \$87.5 of distributable earnings.
  - Ireland would impose withholding tax on dividend of 20% but under US/Ireland treaty rate is reduced to 0%.
  - On distribution USA MNC would in best case pay additional \$22.5 of federal tax on dividend assuming 100% foreign tax credit. or worst case if no foreign tax credit pay \$35 of federal tax. Not include \$5 state tax.
  - The best case total tax is \$40 (\$12.5+\$22.5+\$5) The worst case total tax is \$52.5 (\$12.5+\$35+\$5)
- **Cash Tax Impact:** Countries where the tax rate is lower than the USA rate or if USA MNC can not claim foreign tax credits avoid triggering actual or deemed dividends.  
**Increased** cash flow of \$27.5 to \$40
- **Effective Tax Rate:** No APB 23 assertion impact is \$40 to \$52.5. With APB23 assertion impact is \$12.5 of current Irish tax paid

# US Executive Order to Reduce Regulations

- The Trump administration has released two Executive Orders restricting new regulations.
- The IRS will not be releasing any substantive guidance (including rev. procs. and rev. rules) for "a while," Robert Wellen, IRS associate chief counsel (corporate), said February 13.
- Wellen noted that the restriction on new guidance is "very broad" and that the IRS is no longer submitting guidance to the Federal Register or to the Internal Revenue Bulletin beyond routine administrative guidance, such as updates to interest rates or mileage allowances.

# An Overview of US Tax Reform

- Fundamental federal income tax reform is more likely to happen now than at any time in recent years. In June 2016, Republicans in the House of Representatives published a tax reform proposal called, "A Better Way Forward on Tax Reform," also known as the "Blueprint."
- The Blueprint includes significant proposals for substantive changes to the Internal Revenue Code that would move business taxation away from traditional measures of taxing income and towards a consumption-based tax system.
- The biggest impacts of the Blueprint include:
  - Cut the top individual rate to 33%
  - **Cut the top corporate rate to 20% (Trump has proposed 15%)**
  - Create a special 25% rate for active business income from a pass-through
  - Repeal most business and individual benefits except for the mortgage interest and charitable deductions and the R&D credit
  - Provide for full expensing of business equipment (including buildings), but limit interest expense
  - **Make business taxes border adjustable**
  - **Move to a territorial tax system with a 100% dividend deduction**
  - **Provide a one-time tax on unrepatriated earnings of 8.75% for cash (and cash equivalents) and 3.5% for everything else with the tax to be paid over an 8-year period**

There are a variety of factors that could delay tax reform. (e.g. Lack of 60 votes, cost, agreement on details.)

What is the timing for tax reform?

- Tax reform could take up much of 2017 and even spill into 2018.
- House Speaker Paul Ryan has stated his intention to pass tax reform legislation in the House prior to the August recess.

# The GOP Blueprint: Border Adjustability

- In countries with VAT, exporter is given rebate on tax, and importer country imposes tax. Not so with US, which has no VAT.
- U.S. exports subject to corporate tax with no rebate, and imports to the U.S. do not bear income tax cost, aside from tariffs that may be imposed.
- Border adjustability will eliminate tax on US exports and eliminate deductions for cost of goods on US imports. This provision is the main revenue raiser in getting a reduced corporate income tax rate to work.
- Will this pass muster under WTO rules, which only allow for border adjustments for indirect (i.e. VAT) taxes, and not for direct (i.e. income taxes)? GOP framing this as a consumption (indirect) tax. Framing matters.
- Political feasibility?
- Consider the various businesses that import materials for sale in the U.S. (Retailers, refiners, auto companies, etc.)
- Koch Industries has come out against proposal.
- Unclear where Trump actually stands on this. First said it was too complicated, then appeared to backtrack. Endorsed plan at GOP conference in Philadelphia.
- Facets of the plan, that have not been fleshed out yet:
  - Exports are excluded from taxable income; expenses allocable to those exports are presumably deductible.
  - Expenses for imports are not deductible; domestic sales are includible in taxable income.

## Things a MNC Should Consider:

- Map out impact on US procurement: direct imports and vendors who may seek to pass cost onto purchaser
- Transfer pricing maybe a planning strategy the extent imports and exports involve related parties
- Need to consider supply chain implications for transaction flow
- Tracking and allocation of costs may be important





# Trump and GOP Comparison

Issue	House Republican Blueprint	Trump Outline
<b>Corporate Rate</b>	20%	15%
<b>Pass-Through Tax Rate</b>	25% rate on active income from a pass-through business with rules to ensure proper amount of income is characterized as compensation.	15% rate for "small and medium sized" pass-throughs with rules to ensure proper amount of income is characterized as compensation.
		No information on threshold for large pass-throughs or how they would be taxed.
<b>Business Benefits</b>	Generally repeals tax benefits but specifically retains an R&D credit and a last in, first out method.	Generally repeals tax benefits with no mention of campaign proposal to retain R&D credit.
	NOL can be carried forward indefinitely but cannot reduce taxable income below 90% or be carried back.	
<b>Depreciation</b>	100% expensing for all business equipment, including buildings.	No mention of campaign proposal for full expensing.
<b>Interest Deduction</b>	Disallows deduction for interest expense in excess of interest income with special rules to retain deduction for banks and other financial companies.	No mention of campaign proposal to limit interest deductions if claiming full expensing.
<b>Incentives for Domestic Activity</b>	Creates full "border adjustability," meaning no deduction for imports while gross receipts from exports are excluded.	No provision, although administration officials have said border adjustability does not work in current form.
<b>International</b>	100% exemption for repatriated dividends.	Territorial exemptions for offshore income at unspecified rate.
	Imposes one-time tax on previously unrepatriated earnings of 8.75% for cash and 3.5% for reinvested earnings (with eight-year payment period)	One-time tax on unrepatriated earnings at unspecified rate (campaign proposed 10%)
<b>Net Investment Income Tax</b>	Repeals	Repeals

# What is the US MNC Impact?

## Things a MNC Should Consider: Reduction of corporate income tax rate:

- How will US new US rate compare to foreign jurisdictions you operate in? Higher, same or lower (ex. CA-25%, UK-17%, Aus-30%, India-35%)
- Should a US MNC move foreign business profits to the US before tax reform takes effect?
- Will US MNC be in excess FTC position and need to generate lower tax foreign source income to avoid credit limitation.
- Should US MNC "push" debt from US to higher tax foreign jurisdictions?
- Should a US MNC consider moving intellectual property to the US?

## One time tax on repatriated earnings:

- What is the APB23 position impact?
- Are you better off repatriating and claiming foreign tax credits vs under tax reform paying 10% or 8.5% tax?
- Do you have good tracking of earnings and profit pools in order to make a decision? Do you have an earnings and profits strategy?
- What are the treasury implications of cash repatriation?
- Will there be a sunset provision similar to 2005 which impacts timing of decisions?
- Will there be a requirement to invest repatriated cash in US infrastructure similar to 2005?

## International tax system change:

- Territorial system may favor generating profits in countries with a lower tax rate relative to the US
- Trump proposal tax worldwide profits at 15% eliminates Deferral and may create excess foreign tax credits if earnings are from higher tax countries and immediate tax if earnings are from lower tax countries
- In either proposal subpart F would go away

## Border Adjustability - Things a MNC Should Consider:

- Map out impact on US procurement: direct imports and vendors who may seek to pass cost onto purchaser
- Transfer pricing maybe a planning strategy the extent imports and exports involve related parties
- Need to consider supply chain implications for transaction flow
- Tracking and allocation of costs may be important

# THE STATE OF THE UNION



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# The UK Strategy Publication: Are You Ready?

- **What:** 2016 Finance bill requires certain companies to publish their tax strategy online as it relates to, or affects, UK taxation. Potential reputational and financial impact if non compliance. In the US as it relates to UK taxation:
  - Approach of business to risk management
  - Extensive business viewpoint towards tax planning
  - Level of risk business is willing to accept
  - Approach for dealings with HRMC
- **Who:** Applies to UK business:
  - Within the scope of CbC reporting
  - UK groups revenue > 200M pounds
- **When:** First financial year that begins after September 15, 2016. Must be published annually
- **Where:** Published annually on the internet for the period covering the business's annual report or accounts and before the end of the year of each current financial year

# Brexit

- On June 23, 2016, the people of the United Kingdom voted for "Brexit" and to leave the EU.
- Theresa May, newly appointed leader of the Conservative party and Prime Minister of the UK, triggered Article 50 on March 29, 2017, which officially starts the process for the UK to leave the EU. Negotiations to begin in May or June.
- On April 18, 2017, May surprisingly announced that the government would seek to hold a general election on June 8.
- A large risk is the potential loss of passporting rights for firms based in the UK that are looking to sell services into the EU.
- Business may wish to look at their footprint to re-determine if all their cross border operations are required given that greater complexity usually comes with greater cost.



# Brexit: What are the Tax Implications?

- **Depends:** Impact will not be known until exit is negotiated by UK and EU (i.e. hard vs soft exit)
- **Possibilities:**
  - UK joins EU Free Trade association and EU Economic area and continue to contribute to EU spending (e.g. Norway)
  - UK negotiates a standalone free trade agreement (e.g. Swiss)
  - UK negotiates ongoing customs union with EU (e.g. Turkey)
- **Potential implications:**
  - Corporate transactions and withholding taxes: EU parent Subsidiary directive which eliminates withholding tax on dividends, interest and royalties between EU enterprises no longer applies. Risk of double taxation. EU Merger directive may no longer apply. EU capital duties directive may no longer apply.
  - Corporate tax systems: UK no longer will have to maintain a tax system consistent with EU law. However, if UK joins the European Economic Area (EEA), it would still be subject to these restrictions. The EU has pushed for harmonization of corporate tax. The UK may take different approaches.

# EU Anti-Tax Avoidance Directive

- On July 12, 2016, the Economic and Financial Affairs Council (ECOFIN) of the European Union (EU) reached final agreement on the EU's anti-tax avoidance directive (the Directive).
  - The Directive will apply to any taxpayer that is subject to corporate tax in one or more EU member states, including permanent establishments or subsidiaries based in a "third country."
    - The Directive strives to accomplish this goal by establishing minimum standards with respect to the following five areas:
1. **An interest deductibility limitation to discourage companies from creating debt arrangements to minimize taxes through earnings stripping.**
    - "An interest deductibility limitation to discourage companies from creating debt arrangements to minimize taxes through earning stripping" targets earnings stripping by limiting deduction of exceeding borrowing costs to 30% of taxable income before interest.
    - The rules also include exemptions, a de minimis threshold, equity escape rules, group ratio rules and grandfather provisions. *In general, the rules are similar in nature to those recommended by the OECD under BEPS Action 4.*
  2. **A general anti-abuse rule (GAAR) to counteract aggressive tax planning whereby one of the main purposes is obtaining a tax advantage by avoiding otherwise applicable tax provisions.**
  3. A controlled foreign company (CFC) rule to discourage artificial profit shifting to low- or no-tax countries.
  4. **Hybrid mismatch rules to prevent companies from exploiting differences in legal characterization to reduce taxation.**
  5. An exit tax on assets moved from a member state's jurisdiction under certain circumstances.
    - **Effective Date**
- Member states will generally have until Dec. 31, 2018, to implement the Directive provisions covering hybrid mismatches, interest limitations, CFCs and GAAR in their local laws to be effective as of Jan. 1, 2019.
  - Member states have until Dec. 31, 2019, to implement the exit taxation rules in their local laws to be effective as of Jan. 1 2020.

# Essential Tax Considerations Affecting Global Treasury Management:

- US Section 385: Debt vs. Equity Characterization
- Country Limitations on Interest Deductibility
- Special Purpose Entities
- US Section 987: Realized Gain or Loss Regulations



# An Overview of US Section 385

**Why do we care whether an instrument is characterized as debt or equity for tax purposes?**

- Interest is generally deductible; dividends are not.
- Withholding tax consequences on cross border payments of interest may differ from the withholding tax on dividends.
  - For example, under the terms of a treaty, an issuer of debt may be able to pay interest to a foreign lender free of withholding, whereas a dividend payment to a shareholder may be subject to withholding tax up to 30%.
- International and state and local tax consequences.
- Due diligence in mergers and acquisitions and other transactions.
- Proper written documentation is more important than ever.

**Section 385 " the good old days":** 13 factor test developed by case law to determine whether an instrument is debt vs equity: (1) name or label, (2) fixed maturity date, (3) source payment, (4) right to enforce payments, (5) participation in management, (6) status in relation to regular corporate creditors, (7) intent of the parties, (8) identity of interest between creditor and stockholder, (9) thinness of capital structure in relation to debt, (10) ability of corporation to obtain credit from out side sources, (11) use to which advances were put, (12) failure of the debtor to repay, (13) risk involved in making advances.

# The Impact of the New Final US Section 385 Regulations:

## **Direct Impact:**

- Change the standards for evaluating debt vs. equity on prospective instruments.
- Significantly increase the complexity required to sustain debt treatment, and require burdensome compliance exercises.
- Increase scope and cost of due diligence on M&A transactions.
- Result in lost interest deductions and withholding on interest payments treated as dividends.

## **Possible Collateral Consequences:**

- Treaty disqualification may no longer meet ownership requirement of a derivative benefits test.
- Hybrid Instruments – Does this throw you into BEPS?
- Numerous potential state tax issues.
- The recharacterized debt may cause a transferor to fail to obtain Section 368(c) control required by numerous provisions such as reorganizations, liquidations, and corporate formations and affiliation for consolidated return purposes.

\*non exhaustive list

# Country Limitations on Interest Deductibility

- **Thin Capitalization**: Refers to companies financed through relatively high level of debt compared to equity.
- **Interest Capping**: Earnings requirements on related party interest expense. e.g., Only allowed deduction of interest provided amount does not exceed a certain percentage.
- **Preferred Tax Regime**: Revenues that are untaxed abroad or subject to income tax at a rate lesser than a certain percentage of the country's income tax rate, shall be deemed subject to preferred tax regimes and non-deductible.
- **Earning Stripping Rules**: Occurs when companies in high-tax jurisdictions move earning low-tax jurisdiction. Often, earnings stripping arrangements involve the extension of debt from one affiliate to another. Earning stripping rules limit the allowable interest deduction.
- **Recharacterization of Payments**: Interest expense re-characterized as a dividend (U.S.)

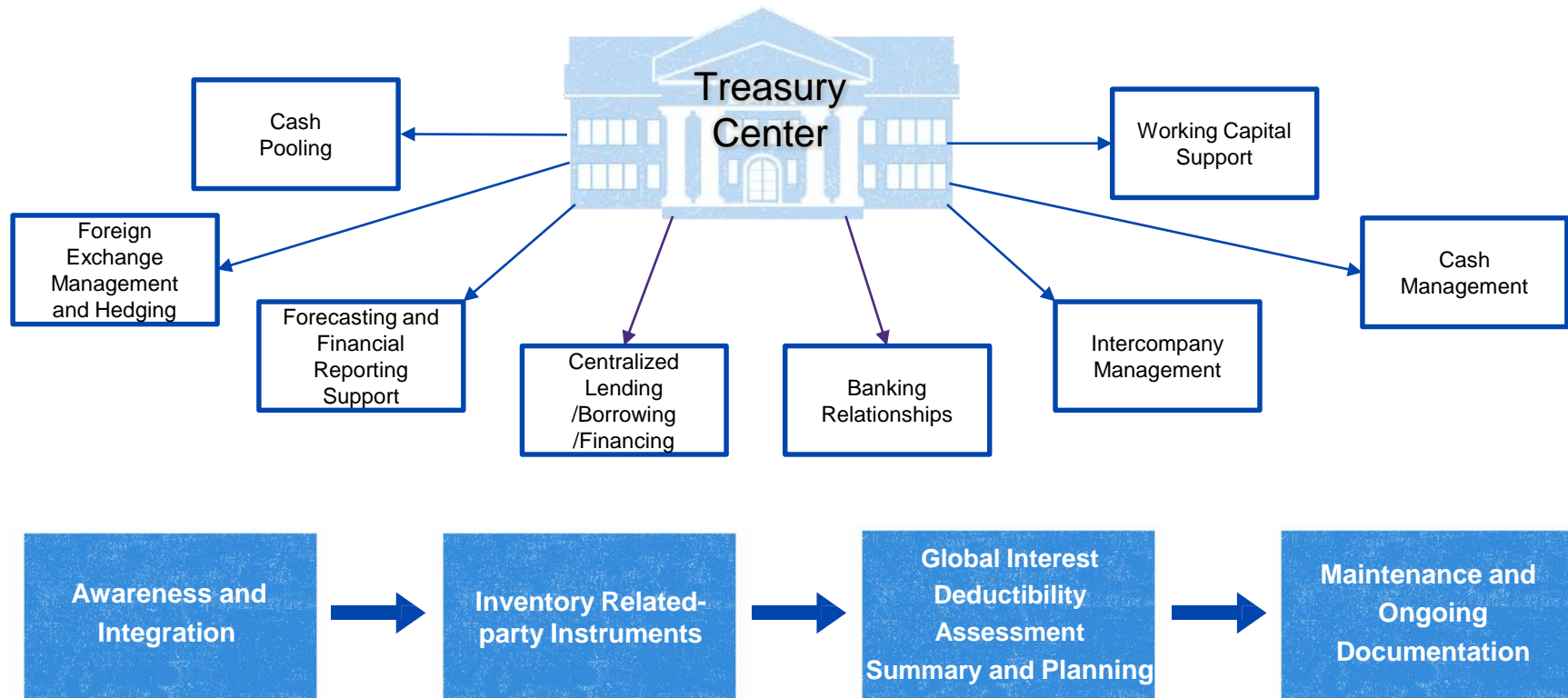
# Country Limitations on Interest Deductibility

Country	European Union	OECD	Thin Capitalization/ Safe Harbor Rules	Approach to Limit Abuse	Financial Test	Arm's Length Deductibility
Argentina			Yes	Balance Sheet	Debt-to equity ratio not to exceed 2:1 (general) / 3:1 ratio (black and grey lists)	Yes
Brazil			Yes	Balance Sheet	Debt-to equity ratio not to exceed 2:1	Yes
Canada		X	Yes	Balance Sheet	Debt-to equity ratio not to exceed 1.5:1	Yes
China			Yes	Balance Sheet	Debt-to equity ratio not to exceed 2:1 in the non-financial industries and 5:1 in the financial industries	Yes
Denmark	X	X	Yes	Balance Sheet & Income Statement	(1) Debt-to equity ratio not to exceed 4:1 and apply to controlled debt that exceeds DKK 10 million. (2) Interest expenses not to exceed 80% of EBITA	Yes
France	X	X	Yes	Income Statement	Maximum of 75% of financial expenses exceeding €3 million may be deducted	Yes
Germany	X	X	Yes	Income Statement	Net interest expense limited to 30% of EBITDA	Yes
India			No / N.A.	No / N.A.	No / N.A.	Yes
Ireland	X	X	No / N.A.	No / N.A.	Other anti-avoidance provisions	Yes
Japan		X	Yes	Income Statement	Net interest expense to a related party is limited to 50% of the adjusted income	Yes
Mexico		X	Yes	Balance Sheet	(1) Debt-to equity ratio not to exceed 3:1 (2) preferred tax regime	Yes
Netherlands	X	X	No / N.A.	No / N.A.	Several other provisions that may limit interest expense	Yes
New Zealand		X	Yes	Balance Sheet	Interest deduction limited to the extent the New Zealand group debt percentage exceeds debt-to-assets ratio of 60% and 110% of the ratio of debt-to-assets of the worldwide group.	Yes
Peru			Yes	Balance Sheet	Debt-to equity ratio not to exceed 3:1	Yes
Switzerland		X	Yes	Balance Sheet	Minimum equity required for each asset class (e.g. investments may be financed by 70%, receivables by 85%, intellectual property by 70%)	Yes
United Kingdom		X	Yes	Income Statement	Interest expense limited to 30% of the group's U.K. EBITDA	Yes
United States		X	Yes	Balance Sheet & Income Statement	Section 163(j) of the IRC denies a U.S. tax deduction for excess interest paid by a corporation to a related party when the corporation's debt to equity ratio exceeds 1.5 to 1 and the net interest expense exceeds 50% of the corporation's adjusted taxable income.	Yes

# Preparing for the Global Interest Deductibility Rules

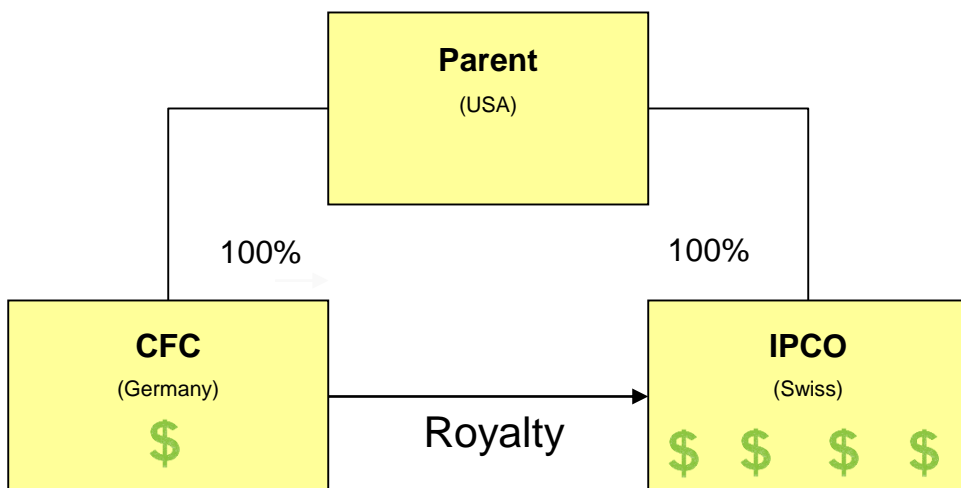
**Align Functions:** International and state tax functions and U.S. and Non-U.S. treasury functions will need to become more closely aligned. Never before have treasury function activities had such profound tax implications.

**Process & Controls:** Ongoing documentation is required as part of maintenance (e.g., documenting payments), it is advisable to institute strict controls with procedures that must be followed when entering into, or making payments on, all related-party instruments.



# Special Purpose Entities: Cash Collector?

**Global Dev. Agreement:**  
US & IPCO Share costs  
based on revenue



- Companies can utilize special purpose entities to help manage cash
- Common examples include:
  - Intellectual Property Company (IP Co.)
  - Procurement Company (Pro Co.)
  - Finance Company (Fin Co.)
  - Foreign Manufacturing Principal
  - Foreign Service Principal
- Generally placed in countries with low tax rates and/or large treaty network

# US Section 987: An Overview

- On December 7<sup>th</sup>, 2016, the U.S. Treasury Department released the final regulations under Section 987.
- The new regulations came in at just over **260 pages**, and is largely based on the 2006 proposed regulations.
- These regulations provide guidance for certain qualified business units (QBUs) to properly determine earnings and profits with respect to certain branch transactions that use a functional currency other than the dollar.
- The regulations also provide guidance on timing, amount, character, and source of any Section 987 gain or loss.

## Recent Currency Trends

- The Canadian dollar is down more than 23% against the U.S. dollar in the past 2 years.
- The Australian dollar is down more than 18% against the U.S. dollar.
- The Wall Street Journal's U.S. Dollar Index increased 34% since July 2014.
- Post Brexit, the British pound hit a 31-year low against the U.S. dollar.

# The Scope of US Section 987

- The new US Section 987 regulations generally apply to Section 987 QBUs of an individual or corporation.
- The regulations do not apply to "excluded entities."
  - Banks, insurance companies, leasing companies, certain finance coordination centers, regulated investment companies, real estate trusts, trusts, estates, S-corporations, and certain partnerships.
- The regulations apply only to partnerships where all partners are related under Sections 267(b) or 707(b).
  - Referred to as "aggregate partnerships" because the regulations treat them as an aggregate of its partners, not as an entity.
- The preamble to the final regulations provides that "excluded entities" must use a reasonable method to comply with Section 987 and cannot rely on the final regulations.



# Tax Best Practices in Global Treasury Management

# 15 Effective Cross-Functional Best Practices

1. A consistent and proactive cross functional team
2. Monthly visibility to where the cash is
3. How to use Information
4. Education & buy in of legal, tax, treasury and controllership groups
5. Country Survey of Attributes Impacting Cash Repatriation
6. Follow up Calls with top 10-15 countries (i.e. 80% of cash)
7. Monthly Tracking Report: ensure countries are being reviewed for cash repatriation and that transactions planning to move cash is taking place
8. Treasury Dividend Approval Share point site
9. Create Treasury Finance Procedure on cash repatriation
10. Coordination with Effective Tax Rate Forecasting / GAAP Team
11. Coordination with Business Strategies
12. Create an Intercompany Billing Group
13. Contemporaneous Documentation which includes a home and host country well thought out transfer pricing study that aligns with intercompany agreements
14. Legal Entities added through M&A; New business development and or Geographic Expansion
15. Periodic Reporting to Management on Success of Cash Repatriation Program

***One Size does not fit all!***

***Every company should consider what best practices is right for you!!***

# Cross Functional Best Practices

## 1: A consistent and proactive cross functional team approach:

- Assemble a team of subject matter experts (SME) from treasury, legal, global controllership, tax, intercompany billing, (The team) who monitor on at least a quarterly basis the net cash position by legal entity for each country.
- The Team develops the best legal, treasury and tax strategy to move the cash to the point of need in an efficient, cost effective manner which manages FX, financial and tax risk.

## 2: Monthly visibility to where the cash is: Develop core reports needed for effective cash repatriation management:

- Interco payables and receivables by country and legal entity.
- Interco loans between legal entities with amounts outstanding, rate of interest, currency and term of loan.
- Net Cash Position Report: captures by country and legal entity:
  - Cash in local banks
  - Net intercompany payables and receivables
  - Net loan balance
  - Net cash position in the country
- US GAAP US\$/LC Country Balance Sheet from ERP system: Used to estimate a country's current year and cumulative retained earnings are which may be available for repatriation.

## 3: How to Use Information

### For countries with a net positive cash position:

- Stratify the countries based on size of net cash position using the 80/20 principal
- Why is the country in a net positive cash position. (i.e. timing issue such as receipt of advances from customers or pension payments have not been made yet)
- Consider first paying down loan balances owed and or intercompany balances
- Exclude countries which have a AP23 position to permanently reinvest earnings
- Consider best means for repatriating cash (i.e. dividend, capital repayment, structured transaction, other)

### For countries with a net negative cash position:

- What is causing the net negative position?
- Will the net negative position to be short term or long term in nature?
- Is interest expense on any loan is deductible under the country's thin capitalization rules. If no is tax leakage occurring?
- Consider recapitalization of the legal entity

# Cross Functional Best Practices

## 4: Education & buy in of legal, tax, treasury and controllership groups

- Prior year objectives and outcomes
- Project is management priority
- Cash repatriation objectives: fund share buy backs, pay debt, pay dividends and use cash for CAPX, R&D and or M&A
- Current year repatriation objectives (i.e. amount, cost efficient basis)
- Complete cash repatriation survey (i.e. covered later)
- Identify major countries with 80% of cash for one on one calls
- Timeline of key milestones
- Lessons learned from prior years: such as what countries can do interim dividends; what country dividends need to be done as part of AGM; accounting issues when cash dividends are done

## 5: Country Survey of Attributes Impacting Cash Repatriation

Using interactive share point site collect key information from local controllership.

- Estimated undistributed retained earnings based on local GAAP
- Legal reserve requirements
- Timing Issues:
  - Do dividends need to be included in statutory audit report
  - Can dividends be approved by board of directors as part of AGM or need to be approved by shareholders
  - Can country do interim dividends
  - If country has multi legal entity structure are intra country dividends required
- Withholding tax rules and rates for cross border dividends
- Can dividend be done cashless vs need to move cash
- Preliminary estimate of the amount and timing of current year dividends

# Cross Functional Best Practices

## 6: Follow up Calls with top 10-15 countries (i.e. 80% of cash)

- Identify the top 10-15 countries with material cash available for repatriation and schedule a call with the local treasury, legal, tax and controllership responsible for the country to walk through their survey response and nail down specific issues, amount and timing for dividends or other means to repatriate cash.

## 7: Monthly Tracking Report: ensure countries are being reviewed for cash repatriation and that transactions are executed

Captures by type of transaction (i.e. dividend, share buyback, capital repayment, cross border loan repayment, structured transaction)::

- In US\$ and LC dividends, etc. for the prior year
- US\$ & LC target amount for current year dividends
- Timing of dividend
- Actual amount dividend declared
- Explain variances
- A comments column capturing key information

## 8: Treasury Dividend Approval Share Point Site

Using share point site capture information for proposed dividends:

- Amount and timing of proposed dividend
- Will dividend be cashless or not. If cashless the accounting entries to be made
- Tax implications such as withholding
- Tax memo covering key tax issues
- Local controllership, treasury, and tax approval
- **Global treasury and tax can approve**

## 9: Create Treasury Finance Procedure on Cash Repatriation:

- Finance procedure document the key elements of the cash repatriation process, uses a RACI diagram to outline roles and responsibilities of the cash repatriation process. This policy educates various subject matter functions (i.e. tax, legal treasury, controllership) on the cash repatriation process and approvals required.

**Goal:** No cash repatriation surprises occur.

# Cross Functional Best Practices

## 10: Coordination with Effective Tax Rate Forecasting / GAAP Team

- Timely ETR & cash taxes forecasting teams informed of all cash repatriation transactions and in particular any structured transaction. For example, dividends may generate withholding taxes which may or may not be creditable.
- The Team needs to understand must understand the Company's APB 23 permanently reinvested positions to avoid an earnings surprise
- The repayment of long term intercompany loans or structured repatriation transactions can create accounting issues such as recognition of FX or impact on goodwill in the case of structured transactions which requires input from the company's chief accounting officer.

## 11: Coordination with Business Strategies to provide efficient and cost effective repatriation of cash

- **Global Billing Entity:** If a company has a complex intercompany billing arrangement it may choose to establish a billing entity for example in Ireland or Switzerland which facilitates the moving of cash between legal counterparties.
- **Global Finance Company:** Used to handle internal loans between the legal entities in various countries. This entity could be located in Ireland or be a Swiss branch of a Netherlands company. The recommended approach is to put in place a standard loan agreement with standard terms and conditions between the finance company between the local operating company and the finance company.
- **Global IP Company:** MNC with valuable intellectual property including brand, know how, technology etc. may protect IP by creation of IPCO in country such as Ireland Switzerland or the Netherlands. The IPCO will enter into development agreements with all companies performing R&D will own the IP created. The IPCO permits the MNC to protect its IP, maintain clean ownership of IP, and creates an efficient and cost effective approach for distribution of IP as it expands its global business.
- **Captive Insurance Company:** A global business is subject to a variety of business risk. The MNC will decide what risk it wants to self-insure and what risk it wants to offload to a third party. A MNC may decide to establish a captive insurance company located in a state such as Vermont, or offshore in a country such as Ireland or Barbados.
- **Global Procurement Company:** A large MNC may incur significant spend on a variety of items. To obtain volume purchasing discounts or facilitate the use of best practices for procurement, or to provide an efficient distribution mechanism the MNC may create either a commission or buy sell procurement entity.

# Cross Functional Best Practices

## 12: Create an Intercompany Billing Group

### **Types of intercompany transactions.**

- IP development agreement
- IP license / royalty agreement
- Intercompany loans
- Captive insurance company premiums
- Management Fee
- Cost Pool agreement
- Service agreement for services performed in Home country
- Service agreement for services performed in Host country
- Training services agreement
- Secondment agreements for foreign assignees not covered above
- Intercompany other

### **Intercompany billing group administers the Interco process and helps the Team spot issues:**

- Interco balances are not paid currently basis (i.e. lack of funds)
- Help insure documentation such as treaty residence certificates and or withholding tax certificates are collected in global share point site which reconciles by agreement withholding tax payments to intercompany invoices and stores documents information such treaty residence certificates and or withholding tax certificates; is notarization of treaty residence required; are withholding tax certificates in correct name of entities involved, can a scanned withholding tax certificate be used or is an original required.
- Ensure the intercompany agreements align with the G/L accounts in the ERP system and reports can be generated as required on audit.
- Are periodic intercompany invoices issued Does invoice language align with the intercompany agreements

# Cross Functional Best Practices

## **13: Home and Host country Contemporaneous Documentation: transfer pricing study that aligns with intercompany agreements**

- Most tax authorities require transactions between related parties to be at an arm's length price and require contemporaneous documentation.
- Tells a good story, easy to follow, ties together the business, industry and transfer pricing approach
- Reflective of intercompany agreements and invoices
- Consistent approach across major transactional groupings: countries, regions and business units/segments
- Collect facts, benchmark, and monitor results real time and before the books close
- Global documentation constructed in an efficient, organized fashion (master file approach)
- Use industry and business related factors to support your TP results
- Functional analysis should clearly delineate
  - Who performs the routine (tactical) versus non-routine (strategic) functions
  - Who carries the relevant risks
  - Ownership of assets (such as IP)
  - Differentiate between high value services and routine services
- It is extremely important that all methods have been evaluated and documented why or why not they have been selected.

## **14: Legal Entities added through M&A; New business development and or Geographic Expansion**

Consider cash repatriation implications for both organic and inorganic new legal entities at time of formation acquisition and first year of operation.

- Plans for integrating the new or acquired business into existing businesses
- How will the new operations be funded (i.e. debt vs equity)
- What is the 5 year cash forecast for the operations
- What intercompany transactions will the new business have with existing businesses
- Will the new legal entities sign existing intercompany agreements



# Cross Functional Best Practices

## **15: Periodic Reporting to Management on Success of Cash Repatriation Program**

- The cash repatriated for each of the prior 5 years
- The current year cash repatriated
- Compare cash repatriated to repatriated earnings and explain reason for variances (i.e. AP23)
- Cost efficiency of repatriation (i.e. tax, FX, etc.)
- Major issues impacting repatriation

# Cross Functional Best Practices



Treasury  
Independent of Tax



Treasury and Tax  
Collaboration