21st Annual CFO Roundtable and Tax Director Workshop

International tax update

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1) Refresher on BEPS
   a) Background and overview
   b) Individual country BEPS-like actions
   c) Planning options to consider
2) International tax developments, year in review
3) Common international structures for US Engineering and Construction (E&C) companies
   a) Overview
4) General holding company structure considerations
   a) Key features, challenges, and considerations
   b) Comparison of jurisdictions, Europe and Asia
   c) Illustration of Finance planning
   d) Illustration of Intangible Property (IP) planning
   e) Illustration of Potential Partnership holding structure
   f) Viability post-BEPS & local country action
   g) Future viability of Luxembourg branch structures
   h) Future viability of Irish non-resident structures
5) E&C structures and Subpart F (Foreign base company services income)
Refresher on BEPS
Refresher on BEPS
Background and overview

1) The Organization for Economic Cooperation and Development has continued to intensify its focus on Base Erosion and Profit Shifting (BEPS) through 2015.

2) Beginning in 2012, the OECD BEPS project has been driven by governments of certain OECD member countries, namely, France, Germany, the UK, and the US. The project is closely linked to international tax reform discussions taking place in various individual nations.

3) OECD “Action Plan on Base Erosion and Profit Shifting” released in July 2013, setting forth 15 action areas of focus (see next slide).

4) The OECD expects to deliver final reports on all remaining Actions by October 5th.

5) Individual countries have also focused on BEPS recently, issuing BEPS-driven legislation and regulations individually rather than waiting for final outcomes of the OECD’s project.
Refresher on BEPS
Background and overview

OECD’s 19 July 2013 report set forth its work plans in 15 target areas:

1) Tax challenges of the digital economy – Sept 2014
2) Hybrid mismatch arrangements – Sept 2014
3) CFC rules – Sept 2015
4) Deductibility of interest and other financial payments – Sept/Dec 2015
6) Treaty abuse – Sept 2014
7) Artificial avoidance of permanent establishment status – Sept 2015
8) Transfer pricing for intangibles – Sept 2014/2015
9) Transfer pricing for risks and capital – Sept 2015
10) Transfer pricing for other high-risk transactions – Sept 2015
11) Development of data on BEPS and actions addressing it – Sept 2015
13) Transfer pricing documentation – Sept 2014
14) Effectiveness of treaty dispute resolution mechanisms – Sept 2015
Refresher on BEPS
Individual country BEPS-like actions

1) UK Diverted Profits Tax
   a) Intended to implement OECD framework to prevent artificial avoidance of PEs in line with BEPS Action 7.
   b) Levies a diverted profits tax of 25% on profits economically earned in the UK but diverted out of the UK.

2) Australia Thin Cap Legislation
   a) Changes rewrite the exemption for foreign non-portfolio dividends received by Australian companies.
   b) Reduces debt-equity safe harbor from 3:1 to 1.5:1.

3) France Legislation and Court Rulings
   a) 2014 Finance Law denies deductions for interest payments if payee not subject to corresponding tax on interest income equal to at least 25% or French tax.
   b) French denial of participation exemption on income from shares if income was tax deductible for distributing entity upheld by Constitutional Court.

4) Poland Draft Legislation
   a) Proposed anti-abuse would deny exemptions from withholding tax for inbound and outbound dividends if the principal purpose of the transactions giving rise to the dividends were to benefit from the exemption.
Refresher on BEPS
Additional holding/finance company options to consider

Typical Dutch CV-BV Structure Illustration
CV Reverse Hybrid Blocker
1) Dutch CV pass-through for Dutch purposes and not subject to Dutch tax.
2) Checking the box treats CV as a CFC for US tax purposes, blocking income from being taxable in the US.
3) “Checking the box” to treat BV and OpCos as disregarded prevents interest payments from being treated as Subpart F income.
4) Note: EU inquiry into tax practices of Luxembourg has been extended to Netherlands and Ireland.
Refresher on BEPS
Additional holding/finance company options to consider

Ireland/Netherlands Interest Free Loan (IFL) Illustration
NL/IR Interest Free Loan
1) Transfer pricing considerations related to use of IFL, particularly from Irish perspective.
2) Consider debt-equity issues related to IFL
International tax developments, year in review
International tax developments, year in review

1) Forthcoming regulations regarding partnership nonrecognition of property contributions;
   a) Notice 2015-54: IRS will enact exception to general non-recognition treatment on contribution of appreciated property to a partnership where (1) a related foreign person is a partner and (2) the US transferor and a foreign related person own more than 50% of the partnership interest.
   b) Exception will require recognition of built-in gain under Section 721(c) by US transferor.
   c) Additional modified regulations specific to partnerships under Sections 482 and 6662 forthcoming.

2) IRS 2015 – 2016 Priority Guidance Plan and International Tax
   a) Released 31 July 2015
   b) Treasury to prioritize 39 international tax projects, 5 of which are new, including regulations under Sections 7874, 367, 956, 7701(l), and 304 regarding inversion type transactions.
   c) Plan to be updated and issued periodically to reflect additional priorities, to allow for consideration comments received from taxpayers, and to respond to new developments.
3) CBC Reporting
   a) CBC is designed to increase transparency by providing tax authorities with sufficient information to allow them to determine whether corporate groups have engaged in BEPS-type activities.
   
   b) Requires company to use a consistent three-tier framework for providing information to authorities:
      I. Master File providing high-level information on global business operations;
      II. Local file providing entity-level information on intercompany transactions; and
      III. CBC report providing information on revenue, profit, capital, and other indicators.
   
   c) Under Action 13 and in local legislation being enacted, groups with less than EUR 750 million annual consolidated group revenue would be exempt from CBC reporting.
   
   d) Several nations have followed the OECD’s lead and have reviewed or amended their transfer pricing rules to provide for CBC reporting, with Mexico requiring reporting of certain transactions on a monthly basis and South Korea implementing penalties for failing to report cross-border transactions with foreign related parties.
   
   e) US Treasury Department has announced that it plans to implement CBC reporting requirements in the US for fiscal years beginning in 2016.
   
   f) The US has not yet released a US CBC reporting template; however, it is likely that it will resemble the OECD’s model CBC reporting template.
International tax developments, year in review

4) Tax Court decisions regarding inclusion of stock compensation in cost pool under cost sharing regulations
   a) Tax Court holds in *Altera* case that Treasury’s 2003 issuance of final rule requiring that stock compensation be treated as costs to be shared in CSAs failed to satisfy the reasoned decision making standard and was thus invalid.
   b) Ruling finds that IRS erred in allocating the taxpayer’s stock compensation costs to its CSA cost pool.

5) Newly proposed US model tax treaty in a Post-BEPS world
   a) Tightening of “triangular provision” to deny treaty benefits when certain income is attributable to a PE outside the beneficial owner’s country of residence.
   b) Deny treaty benefits to certain income items benefitting from a “special tax regime” in the beneficial owner’s country of residence.
   c) Modify the LOB article, including adding a “derivative benefits test” and a base erosion prong to the “subsidiary of a publicly traded company” test.
   d) Enable Treasury to “turn off” some benefits in domestic law after tax treaty is signed
   e) May be used to modify current US-Luxembourg treaty to deny current benefits
6) Obama Administration FY2016 Budget Proposal – International Tax Items

a) The latest budget proposal included eight new international tax proposals to enact the following:

I. 19% minimum tax on future foreign earnings;
II. One-time 14% tax on previously untaxed foreign earnings;
III. Real delay in implementation of worldwide interest allocation;
IV. Permanently extend the exception under Subpart F for active financing income;
V. Permanently extend the look-through treatment of payments between related CFCs (i.e., Section 954(c)(6);
VI. Amend the CFC attribution rules of Section 958(b) to turn off downward attribution of stock ownership from a foreign person to a US person;
VII. Eliminate the 30-day rule under Section 951(a) regarding Subpart F inclusions; and
VIII. Treat purchases of hook stock by a subsidiary as giving rise to deemed distributions.

b) Existing or modified proposals call to enact the following:

I. Restrict deductions for excessive interest of members of financial reporting groups;
II. Limit ability of domestic entities expatriate;
III. Prevent use of leveraged distributions from related foreign corporations to avoid dividend treatment;
IV. Provide incentives for repatriating operations and deny deductions associated with expatriation;
V. Limit shifting of income through intangible property transfers;
VI. Modify treatment of dual capacity taxpayers;
VII. Tax gain from the sale of a partnership interest on a look-through basis;
VIII. Restrict use of transactions that create stateless income; and
IX. Remove foreign taxes from a section 902 corporation’s foreign tax pool when earnings are eliminated.
Common international structures for US E&C companies
Common international structures for US E&C companies – Overview

1) E&C services companies generally operate either through a “flat” structure or a holding company structure (sometimes a combination of both).
   a) For operations in high-tax jurisdictions, flat structures are satisfactory
      i. Little need to defer earnings because of ability to repatriate tax-efficiently
   b) However, as corporate tax rates continue to decrease relative to that of the US, holding company deferral structures are becoming increasingly advantageous and common.
      i. Common operating jurisdictions with “lower” tax rates include the UK, Ireland, Singapore, China, Netherlands, France, Australia, and even Canada and Germany.
Common international structures for US E&C companies – Overview

**General “Holding Company” structure**
Defers US Tax

- **US Parent (US)**
- **Foreign HoldCo (Low-Tax Jdx)**
- **Foreign OpCo1**
- **Foreign OpCo2**
- **Foreign OpCo3**

- Dividend
- Loan (Redeployment: new foreign investment)

- Sales Revenue
- Local Country Customers

**General “Flat” structure**
Movement of Funds Subjected to US Tax

- **US Parent (US)**
- **Foreign HoldCo (Low-Tax Jdx)**
- **Foreign OpCo1**
- **Foreign OpCo2**
- **Foreign OpCo3**

- Dividend
- Loan (Redeployment: new foreign investment)

- Sales Revenue
- Local Country Customers
General holding company structure considerations
General holding company structure considerations
Key features, challenges, and considerations

Key structure features
1) Deferral of foreign earnings for US federal tax purposes (assuming compliance with anti-deferral rules, including Subpart F);
2) Ability to reinvest tax-deferred earnings in foreign expansion, investment, acquisitions;
3) Tax efficient treasury function (e.g., cash redeployment strategies and access to funds);
4) Operational alignment, reporting and improved local risk management;
5) Local tax attribute management (e.g., access to FTCs, NOLs, etc.);
6) Local country tax management, including withholding taxes and tax upon disposition of shares or operations;
7) Potential for finance company and/or intangible property and licensing planning.

Key challenges
1) Process to reorganize into a holding company structure can sometimes be costly and complex;
2) Foreign perception of “reporting lines” resulting from legal entity structure;
3) Cash must generally remain outside of US parent group’s control in order to benefit from lower foreign effective tax rate(s).
General holding company structure considerations
Key features, challenges, and considerations

Key considerations
1) Participation exemption on dividends received from subsidiaries;
2) Participation exemption on gains on sales of subsidiaries;
3) Withholding tax on dividend distributions by HoldCo
4) Local Controlled Foreign Corporation (CFC) rules;
5) Stamp duty on sale of subsidiaries;
6) Capital duty on contribution into HoldCo;
7) Legal system allowing for efficient corporate management;
8) Favorable location for hiring management personnel;
9) Wide income tax treaty network with jurisdictions where company operates;
10) Local Tax and legal system with respect to IP and finance planning;
11) Low tax rate on operations;
12) Various tax incentives for R&D, financing function, and headquarters;
13) Fast and efficient tax and legal ruling system;
14) Favorable geographic location (i.e., easy international access); and
15) Public perception, “fair tax”
## General holding company structure considerations
### Comparison of jurisdictions

<table>
<thead>
<tr>
<th>Category</th>
<th>Ireland</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CIT Rate</strong></td>
<td>12.5%</td>
<td>20% (dropping to 18% in 2020)</td>
</tr>
<tr>
<td><strong>W/H Taxes (Payments to US)</strong></td>
<td>1. Dividends – 0%</td>
<td>1. Dividends – 0%</td>
</tr>
<tr>
<td><strong>US Treaty Rates Applied</strong></td>
<td>2. Interest – 0%</td>
<td>2. Interest – 0%</td>
</tr>
<tr>
<td></td>
<td>3. Royalties – 0%</td>
<td>3. Royalties – 0%</td>
</tr>
<tr>
<td><strong>Capital Gains Tax (Sub Sale)</strong></td>
<td>0%*</td>
<td>0%*</td>
</tr>
<tr>
<td><strong>Thin-Cap Rules</strong></td>
<td>NO – but interest paid to certain nonresident affiliates may be reclassified as a dividend distribution</td>
<td>YES – interest deductions subject to arm’s length principles</td>
</tr>
<tr>
<td><strong>Use of NOLs</strong></td>
<td>Carryback 1 Year//Carryforward No Limit</td>
<td>Carryback 1 Year//Carryforward No Limit</td>
</tr>
<tr>
<td><strong>Extent of Treaty Network</strong></td>
<td>Average (over 55 treaties)</td>
<td>Excellent (over 120 treaties)</td>
</tr>
<tr>
<td><strong>Tax Rulings Available</strong></td>
<td>YES, can obtain advance statutory clearance</td>
<td>YES, can obtain advance statutory clearance</td>
</tr>
<tr>
<td><strong>Transfer Pricing Rules</strong></td>
<td>YES (arm’s length principle)</td>
<td>YES (arm’s length principle)//(OECD Guidelines)</td>
</tr>
<tr>
<td><strong>Anti-Deferral Rules</strong></td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td><strong>Consolidated Filing Available</strong></td>
<td>NO (but loss sharing permitted)</td>
<td>NO (but loss sharing permitted)</td>
</tr>
<tr>
<td><strong>VAT Tax Rate</strong></td>
<td>YES – generally 23%</td>
<td>YES – generally 20%</td>
</tr>
<tr>
<td><strong>Participation Exemptions</strong></td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td><strong>Proximity to Major European Markets</strong></td>
<td>Island Location – Close to UK but not Germany</td>
<td>Island Location</td>
</tr>
<tr>
<td><strong>Functional Currency</strong></td>
<td>Euro</td>
<td>British Pound</td>
</tr>
<tr>
<td><strong>Treaty with HK or Malaysia</strong></td>
<td>YES</td>
<td>YES</td>
</tr>
</tbody>
</table>

*The 0% rate is applicable if participation exemption rules are met.*
# General holding company structure considerations
## Comparison of jurisdictions

<table>
<thead>
<tr>
<th></th>
<th>Luxembourg</th>
<th>Netherlands*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CIT Rate</strong></td>
<td>29%</td>
<td>25%</td>
</tr>
</tbody>
</table>
| **W/H Taxes (Payments to US)** (US Treaty Rates Applied) | 1. Dividends – 0%  
2. Interest – 0%  
3. Royalties – 0% | 1. Dividends – 0%  
2. Interest – 0%  
3. Royalties – 0% |
| **Capital Gains Tax (Sub Sale)** | 0%*        | 0%*          |
| **Thin-Cap Rules (Limits Interest Deductions)** | NO – but in practice use debt-to-equity ratio of 85:15 for holding participations | YES – disallow deduction of interest costs relating to excess debt associated with the acquisition price of participations. |
| **Use of NOLs**      | Carryback 1 Year//Carryforward No Limit | Carryback 1 Year//Carryforward 9 Years |
| **Extent of Treaty Network** | Average (over 70 treaties) | Excellent (over 90 treaties) |
| **Tax Rulings Available** | YES | YES |
| **Transfer Pricing Rules** | YES (arm’s length principle) | YES (arm’s length principle) |
| **Anti-Deferral Rules** | NO | NO |
| **Consolidated Filing Available** | YES | YES |
| **VAT Tax Rate**     | YES – generally 17% | YES – generally 21% |
| **Participation Exemptions** | YES | YES |
| **Proximity to Major European Markets** | Close Proximity to Germany, France, UK | Close Proximity to Germany, France, UK |
| **Functional Currency** | Euro | Euro |
| **Treaty with HK or Malaysia** | YES | YES |

*The 0% rate is applicable if participation exemption rules are met.*
## General holding company structure considerations
### Comparison of jurisdictions

<table>
<thead>
<tr>
<th>Category</th>
<th>Hong Kong</th>
<th>Malaysia</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CIT Rate</strong></td>
<td>16.5%</td>
<td>25%</td>
<td>17%</td>
</tr>
<tr>
<td><strong>W/H Taxes (Payments to US)</strong></td>
<td>1. Dividends – 0%</td>
<td>1. Dividends – 0%</td>
<td>1. Dividends – 0%</td>
</tr>
<tr>
<td></td>
<td>3. Royalties – 4.95% or 16.5%0%</td>
<td>3. Royalties – 10%</td>
<td>3. Royalties – 10%</td>
</tr>
<tr>
<td><strong>Capital Gains Tax (Sub Sale)</strong></td>
<td>0%</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Thin-Cap Rules (Limits Interest Deductions)</strong></td>
<td>None</td>
<td>Rules currently deferred</td>
<td>None</td>
</tr>
<tr>
<td><strong>Use of NOLs</strong></td>
<td>NO Carryback//NO Carryforward limit</td>
<td>NO Carryback//NO Carryforward limit</td>
<td>1 yr Carryback//NO Carryforward limit</td>
</tr>
<tr>
<td><strong>Extent of Treaty Network</strong></td>
<td>Expanding network</td>
<td>Excellent (over 66 treaties)</td>
<td>Excellent (70 treaties, but not US)</td>
</tr>
<tr>
<td><strong>Tax Rulings Available</strong></td>
<td>YES, can obtain advance statutory clearance</td>
<td>YES, can obtain advance statutory clearance, but limited to assoc. person</td>
<td>YES, framework in place</td>
</tr>
<tr>
<td><strong>Transfer Pricing Rules</strong></td>
<td>Developing</td>
<td>YES (arm’s length principle)//(OECD Guidelines)</td>
<td>YES (arm’s length principle)//(OECD Guidelines)</td>
</tr>
<tr>
<td><strong>Anti-Deferral Rules</strong></td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td><strong>Consolidated Filing Available</strong></td>
<td>NO</td>
<td>NO (but loss sharing permitted)</td>
<td>NO (but loss sharing permitted)</td>
</tr>
<tr>
<td><strong>VAT/GST Tax Rate</strong></td>
<td>NO</td>
<td>6%</td>
<td>7%</td>
</tr>
<tr>
<td><strong>Participation Exemptions</strong></td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td><strong>Proximity to Major APAC Markets</strong></td>
<td>Close proximity to PRC</td>
<td>More remote</td>
<td>More remote</td>
</tr>
<tr>
<td><strong>Functional Currency</strong></td>
<td>Hong Kong Dollar</td>
<td>Ringgit</td>
<td>Singapore Dollar</td>
</tr>
</tbody>
</table>
General holding company structure considerations

Illustration of finance planning

**Illustrative example of regional holding structure**

**Key characteristics**

1. Holdco is established in a jurisdiction with favorable holding company attributes.
2. Local country profits are distributed to Holdco in the form of a dividend and available for reinvestment through expansion or acquisition.
3. Cash is centralized at a Finance Company, optimally with tax efficient treatment of interest. Lent throughout group as needed. Could act as a Treasury center with cash pooling.

US Federal Income Tax Legend

- □ Corporation
- ○ Branch or Single Member LLC
- ◊ Hybrid (disregarded) Entity
- ▼ Reverse Hybrid (regarded) Entity
Illustrative example of IP planning structure

Key characteristics

1. Global Holdco is located in a jurisdiction with a favorable treaty network and suitable for subsidiaries in Europe, Asia-Pac or other jurisdictions.

2. Global Holdco is able to move non-US Intangible Property (IP) into a special purpose company formed outside of the US.

3. Global Holdco has similar attributes as the regional Holdco, but also can hold and manage IP.

4. Though many E&C services firms may not hold “traditional” IP such as patents and copyrights, there is potential to qualify certain “know-how” IP for intangible planning including:
   a) Processes;
   b) Trade secrets;
   c) Leverageable blueprints;
   d) Workforce in place.
General holding company structure considerations
Illustration of potential partnership holding structure

Illustrative example of foreign partnership holding structure

Key characteristics
1. Foreign Partnership established above Foreign HoldCo.
2. Enables efficient contribution of resources to foreign structure from various US Subs.
3. Interest payments made by and received by Foreign Partnership may be considered FSI due to pass-through nature of foreign partnership.
4. Retains many of the advantages of HoldCo Structures identified in earlier slides.
5. Strict business purpose required
6. Complexity to implement
General holding company structure considerations
Viability post-BEPS & local country action

1) Many traditionally popular structures are now being challenged—largely as a result of BEPS and recent local country legislation, including:
   a) Luxembourg Branch Structures
      i. Proposed US-Luxembourg treaty would deny many benefits available
   b) Irish Non-Resident Structures
      i. New legislation provides that all companies incorporated in Ireland will be treated as Irish tax residents
Typical “Inbound” LuxCo with US Finance Branch
1. LuxCo acquires loan receivables from US Sub in exchange for equity
2. LuxCo creates a US Branch and allocates receivables to US Branch
3. US Sub pays interest, which is not taxed in Luxembourg by virtue of US–Lux treaty. Generally treatment confirmed by obtaining ruling in Luxembourg.
4. No WHT on US source interest/royalty payments.

Continued Viability of LuxCo with US Branch
2. New Model US treaty would deny benefits resulting from a “special tax regime” and those attributable to any PE outside the beneficial owner’s country of residence.
3. Due to the pressure by the US, Luxembourg has announced it will no longer issue rulings on income tax as of August 2015. Existing structures are grandfathered until changes to the US Lux Treaty are ratified or Luxembourg domestic law changes.
4. But “Outbound” structures?
General holding company structure considerations
Future viability of Irish non-resident structures

**Typical structure**
1. Irish incorporated but non-Irish tax resident company established (NRI IPCo). NRI IPCo is typically tax resident in 0% tax location.
2. Irish incorporated and Irish tax resident company established (Irish Principal).
3. NRI IPCo acquires non-US IP from existing IP Owner.
4. NRI IPCo licenses IP to Irish Principal who acts as principal sales company for ROW/EMEA/Other.
5. Irish Principal then sells to inter-group/third party distributors.
6. Irish Resident Principal may carry out R&D in Ireland under contract R&D arrangement with NRI IPCo.

**Anticipated tax consequences**
1. Irish Principal taxed at 12.5% on residual profits after royalty paid to NRI (rulings on availability of 12.5% rate of tax not required but available if desired).
2. It is not uncommon for such structures to generate very low effective tax rates (1%-3%).
3. If Irish Principal undertakes R&D activities, any R&D tax credits arising in Ireland can reduce Irish corporation tax with any excess giving rise to possible cash tax refunds in Ireland.
4. Royalty withholding tax mitigation – royalties to NRI should not be liable to RWHT provided certain basic conditions are met.
5. Zero Dividend Withholding Tax from Irish Principal.

**Impact of new legislation – Phase-out**
1. New legislation provides that all companies incorporated in Ireland will be treated as Irish tax residents.
2. For existing companies with Double Irish Structures implemented prior to 1/1/2015, they are grandfathered in and not subject to new rules until 2021. Existing companies will need to consider restructuring options moving forward.
3. Similar legislation enacted in 2013 prevents Irish incorporated companies from being "stateless" (i.e., no subject to tax in any jurisdiction).
4. Ireland is in the process of introducing a “patent box” regime in order to encourage onshoring of IP and to facilitate restructurings required to comply with new law.
E&C structures and Subpart F
Foreign base company services income
Overview of foreign base company service income

1) Foreign Base Company services income (FBCSI) means income (e.g., compensation, commissions, fees, etc.) of a CFC derived in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled industrial, commercial, or like services if:
   a) The services are performed by CFC either for or on behalf of a related person, and
   b) The services are performed by CFC outside the country of CFC’s incorporation.
      I. Location of the personnel when performing the services.
“For or on behalf of” a related person


II. CFC is paid or reimbursed by, is released from an obligation to, or otherwise receives substantial financial benefit from, a related person for performing such services (substantial financial benefit).
   ► Example is subcontracting arrangement between USP and CFC where CFC performs services outside country of incorporation.

III. CFC performs services which a related person is, or has been, obligated to perform (obligation of a related person)
   ► Example is assignment of contract between USP and CFC, where CFC performs services under contract outside country of incorporation.
   ► Exception for certain performance guarantees from a related party.

IV. CFC performs services with respect to property sold by a related person and the performance of such services constitutes a condition or a material term of such sale (material term of sale); or
   ► Example is warranty services for tangible goods between two CFCs.

V. Substantial assistance contributing to the performance of such services has been furnished by a related person or persons (substantial assistance).
Substantial assistance
Current regulations

1) Under current regulations (prior to Notice 2007-13), assistance includes direction, supervision, services, know-how, financial assistance (other than contributions to capital), and equipment, material, or supplies.

2) Assistance furnished by a related person in the form of direction, supervision, services, or know-how is substantial if:
   a) The CFC receives skills that are a principal element in producing the service income (principal element test); or
   b) The cost to the CFC of the assistance furnished by related person equals 50% or more of the total service cost of the CFC after any §482 adjustment (cost test).

3) Financial assistance (other than contributions to capital), equipment, material, or supplies furnished by a related person to CFC is considered assistance only in that amount by which the consideration actually paid by CFC is less than the arm's length charge for such purchase or use.
Substantial assistance
Notice 2007-13

1) Regulations amended because there has been a substantial shift in the global service sector in recent years.

2) The amended regulations no longer treat profits of a CFC contracting to provide services to an unrelated person as FBCSI because of the support services provided by a related foreign person.

3) Substantial assistance rules continue to apply in limited circumstances where a related US person provides sufficient assistance directly or indirectly to a related CFC.

4) Principal element test is eliminated.

5) Cost test will be satisfied and hence substantial assistance exists if the cost to the CFC of the services furnished by the related US person at least 80% of the total cost of the CFC of performing the services, after §482 adjustment.

6) List of items that are considered assistance largely the same as the list of items under the current regulations.

7) However, for financial assistance, equipment, material, or supplies, it appears that the cost includes the entire amount that the CFC pays to the related US person, rather than measuring the non-arm's-length amount.
Intangible property issues in context of Subpart F

1) CFC Ireland contracts with unrelated German customer.
2) USP licenses patented process (IP) to CFC in exchange for arm’s length royalty.
3) CFC performs services to German customer outside of Ireland.
4) Does the royalty for licensing IP from USP count as USP’s assistance to CFC?
5) What if CFC acquires IP from USP? Does the IP acquisition cost count as USP’s assistance to CFC?
Application of the cost test

<table>
<thead>
<tr>
<th></th>
<th>Costs in Germany</th>
<th>Costs in the US</th>
<th>Total costs</th>
<th>Exceeded 80%?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yr 1</td>
<td>4</td>
<td>21</td>
<td>25</td>
<td>Yes</td>
</tr>
<tr>
<td>Yr 2</td>
<td>25</td>
<td>0</td>
<td>25</td>
<td>No</td>
</tr>
<tr>
<td>Yr 3</td>
<td>50</td>
<td>0</td>
<td>50</td>
<td>No</td>
</tr>
<tr>
<td>Total</td>
<td>79</td>
<td>21</td>
<td>100</td>
<td>No</td>
</tr>
</tbody>
</table>

Is the cost test applied on an year by year basis or contract by contract basis?
Exception applies only if:

1) USP’s sole obligation with respect to the contract is to guarantee performance of the services;
2) CFC is fully obligated to perform the services under the contract;
3) USP does not in fact pay for performance of, or perform, any of the guaranteed services; and
4) USP does not or pay for performance of, or perform, any significant services related to the guaranteed services.
Performance guarantee exception

1) Prior to CFC’s entering the E&C contract, if USP prepares plans and specifications that enable the submission of bids, USP will have performed significant services related to services that it has guaranteed.

2) In today’s global business environment, affiliates routinely provide significant assistance in proposing bids in foreign countries by CFCs. Such activities often include (i) Prepare bids; (2) Access data stored in common company data bases for comparable projects; (3) Prepare preliminary designs in the bid proposal documents; and (4) Tap into the multinational resources, etc.

3) As a result, performance guarantee under today’s rules can cause problems on the “obligation of a related person” test.
Policy issues of notice 2007-13

1) What is considered assistance in today’s global business environment (e.g., services provided over Internet).
2) Whether financial assistance, equipment, material, or supplies from a related person should constitute substantial assistance if they are arm’s length.
3) Whether technical support is included as part of a services contracts when applying the cost test.
4) Whether intangible property licensed or acquired from US related parties should be considered part of assistance to the CFC.
5) For long-term contract whether the cost test will be applied year by year or based on multiple years.
6) Whether the guarantee exception should be further relaxed.
   a) An objective standard should be introduced.
Subpart F issues in HoldCo structure for E&C companies – Post-Notice 2007-13

1) If HoldCo takes the prime contract and subcontracts with a related CFC.
   b) Maybe FBCSI for the related CFC if the related CFC performs the subcontract
      services outside its country of incorporation.
   c) Solution: Transfer the related CFC into HoldCo and check the box to avoid FBCSI
      for the related CFC.

2) If HoldCo takes the prime contract and subcontracts with USP.
   a) No FBCSI for HoldCo unless the 80% test under Notice 2007-13 is met.

3) If USP takes the prime contract and subcontracts with HoldCo.
   a) FBCSI for HoldCo unless an exception applies.

4) If a related CFC takes the prime contract and subcontracts with HoldCo.
   a) FBCSI for HoldCo.
   b) Solution: Transfer the related CFC into HoldCo and check the box to avoid FBCSI.

5) Conclusion – When HoldCo takes the prime contract, Notice 2007-13 can:
   a) Significantly reduce FBCSI exposure or make such exposure more manageable.
   b) Enhance the feasibility of the holding company structure for E&C companies.
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