# Earnings Stripping:

## The Art of Extracting Pre-tax Dollars Out of the US and How the IRS is Trying to Keep Those $$$ in the USA

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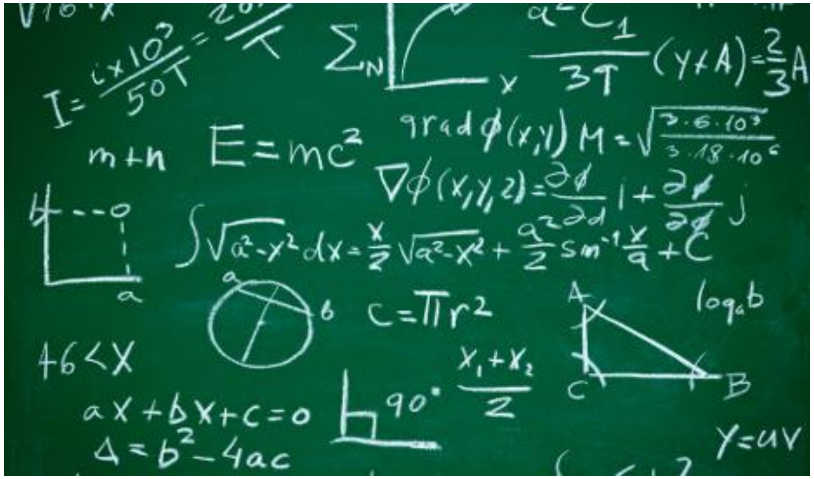
# Earnings Stripping

- **The US has one of the World's highest corporate tax rate**
- **This provides a real incentive to move pre-tax dollars out of the US**

# The Old Earnings Stripping Rules Section 163(j)

**These rules apply to intercompany debt where the US Corporation's debt to equity ratio exceeds 1.5:1**

# The Old Rules




**The 163(j) rules provide a formula which, if exceeded, will limit the tax deductibility of interest paid**

# Proposed New Earnings Stripping Regulations

- New very broad regulations were proposed on April 4, 2016 to run alongside Section 163(j)
- The proposed regulations target transactions that generate large interest deductions by directly or indirectly increasing related-party debt
- **Without financing new investment in the US**

# The New Rules

- **The proposed regulations require certain large corporations to do up-front due diligence and documentation**
- **If these requirements are not met, the debt instruments will be treated as equity for tax purposes**

# The New Rules

- Currently financial instruments are treated as entirely debt or entirely equity for tax purposes
- The proposed regulations allow the IRS **on audit** to divide debt instruments into part debt and part equity

# The New Rules

- The proposed regulations address 6 types of transactions
- If a transaction is caught within the regulations, **debt instruments will be treated as equity for tax purposes**

# The New Rules

**The targeted affiliate transactions are:**

- Distributions of debt instruments by corporations to their related shareholders
- Issuances of debt by corporations in exchange for affiliate stock

# The New Rules

- **Issuances of debt as consideration in internal asset reorganizations**
- **Related-party debt instruments issued to fund a distribution of cash or property to a related shareholder**

# The New Rules

- **An acquisition of affiliate stock from an affiliate**
- **Acquisitions of property from an affiliate under an internal asset reorganization**

# The New Rules

**The consequence of having intercompany debt reclassified as equity**

- Loss of interest deduction
- Possible withholding tax of 30% unless reduced by treaty

# Is this the End of Earnings Stripping?

**There is a wide range of other earnings stripping techniques including…**

# Is this the End of Earnings Stripping?

- Intellectual property migration
- Licensing intangibles for royalties
- Leasing of tangible property to a US affiliate
- Management fees
- Other related-party service fees
- Supply chain restructuring transactions

# Thank You

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