New Beginnings – New US Tax Regime: Time to Re-Think Planning Paradigms

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New International Tax Paradigm: Upends Planning of Past 50 or more years

- Outbound Blocker Structures No Longer Block
  - All income abroad must bear minimum tax rate
- Everything is a CFC
  - No 30 day “grace” period
  - Foreign to Domestic Attribution of Ownership of Shares
- Large Margin of rates between C corporation and Flow-through Entities (21% v. 37%)
- Limitations of Deductibility for Business Interest and Payments Involving Related Hybrid Entities or Hybrid Transactions

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Everything is a CFC?

- CFC = Controlled Foreign Corporation in which US Shareholders own more than 50% of vote or value
  - US Shareholder now defined as one owning at least 10% of vote *or value*
  - Old Law set test at 10% of vote:
    - That led to planning with non-voting shares held by US persons in non-US corporations
    - Concentration of value in non-voting shares meant no status as "US Shareholder"
- Now, Holding Shares worth at least 10% of Value of Company means that "US Shareholder" and Company More Likely CFC

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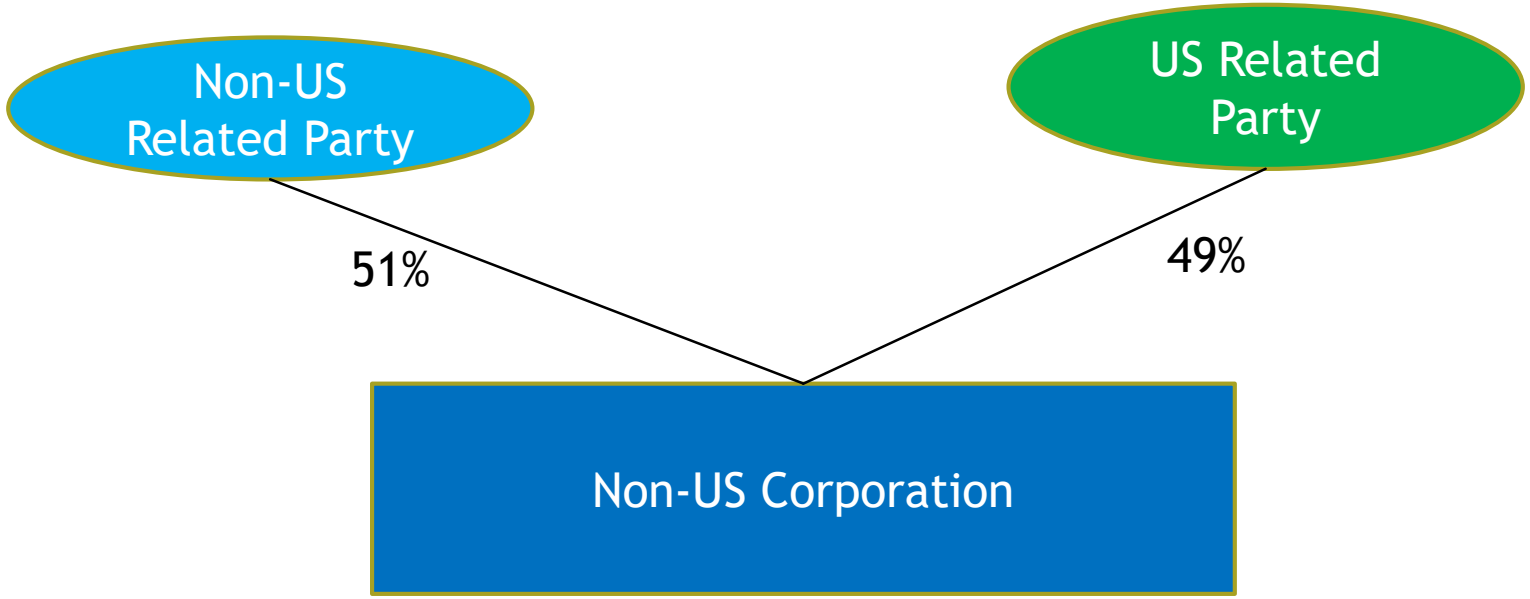
Everything is a CFC?

- Old Law: No attribution of share ownership from Non-US Person to US Person for Testing Status as CFC
  - In other words, if a related foreign shareholder held shares, those shares were deemed non-owned by the related US person



New Law: Now Attribution between Related Persons

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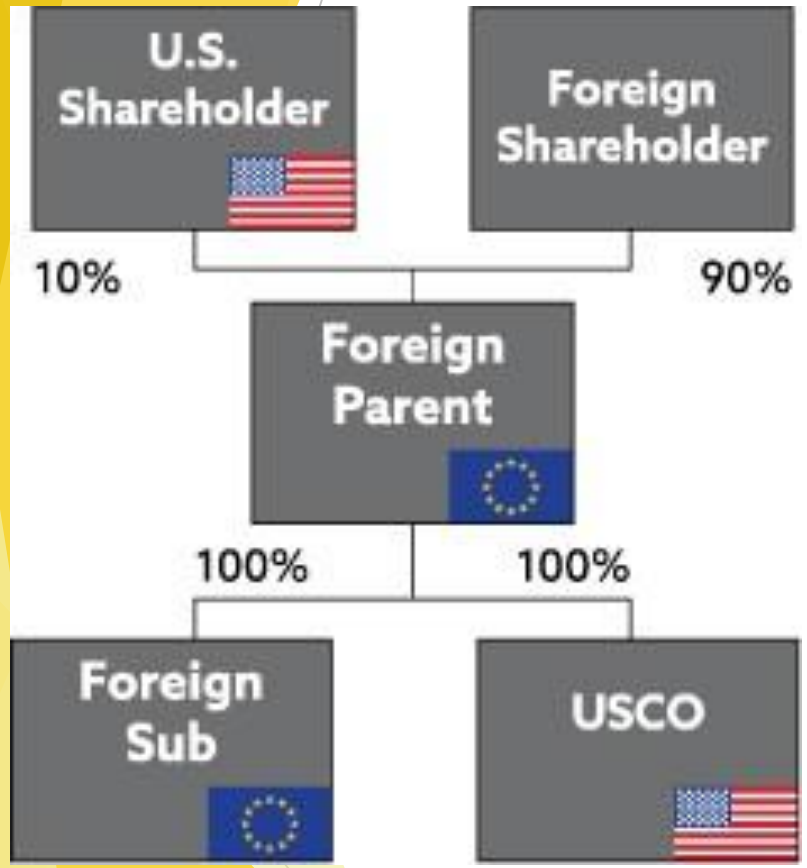
Everything is a CFC?

- CFC Status Results in Deemed Inclusion of "Subpart F income" of CFC
  - Generally passive income
  - Subpart F income also includes many related party transactions
- Old Law: Income inclusion only if US Shareholder owns stock in the foreign company for "an uninterrupted period of 30 days or more during the year"
  - If held less than 30 days in any year, could liquidate company (etc.) without income inclusion
- New Law: Income inclusion for any part of year in which person is a US Shareholder of a CFC

Everything is a CFC?



Post-tax reform: USCo is treated as holding all shares held by Foreign Parent for purposes of identifying CFC status.

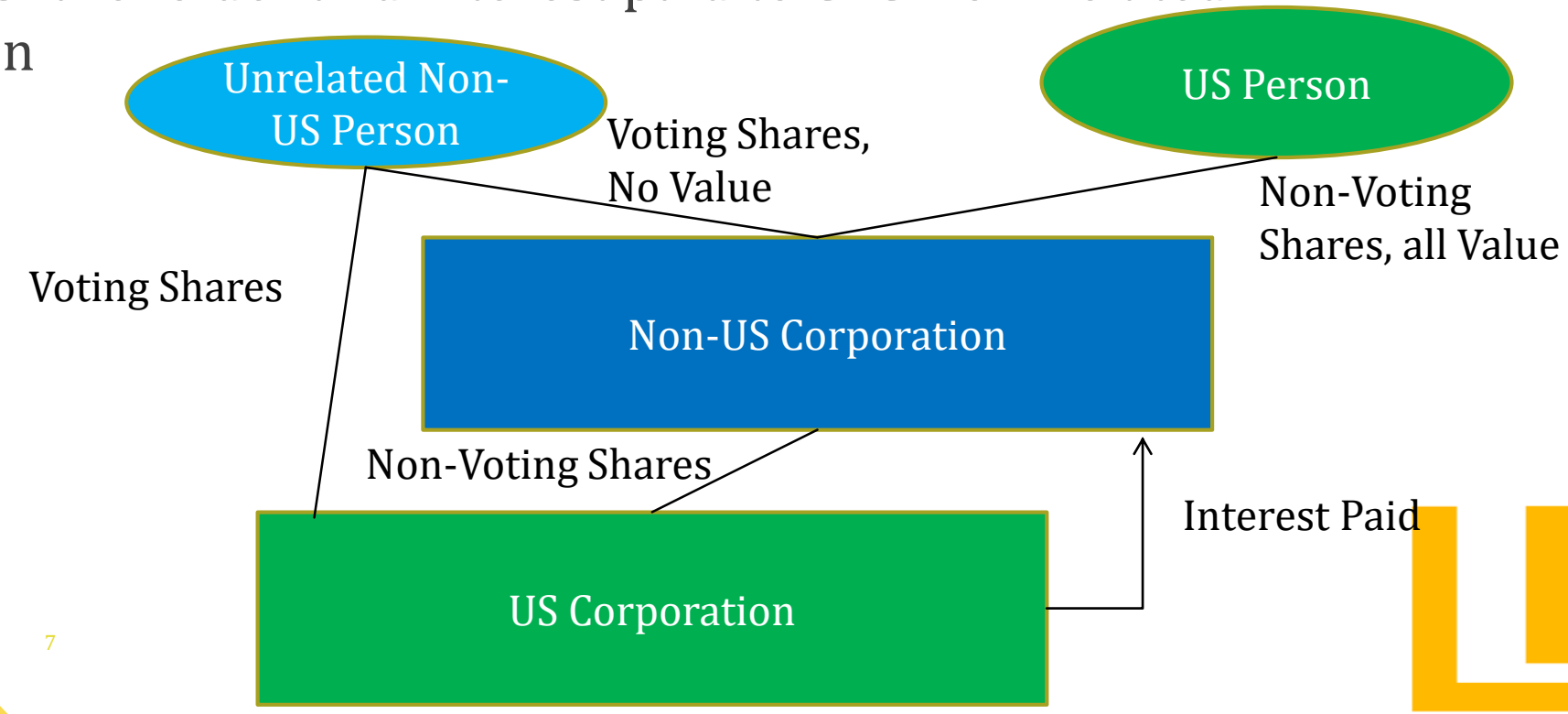
Foreign Sub (but not Foreign Parent) is a CFC.

USCo will not have subpart F inclusions with respect to Foreign Sub, but if there are any 10% U.S. shareholders in Foreign Parent (such as U.S. Shareholder), such shareholders have subpart F inclusions in the future by virtue of indirect ownership in Foreign Sub, a CFC.

Everything a CFC: Traditional Inbound Financing Models Must Change

- "Portfolio Interest" Not Subject to US Withholding or Tax
- Portfolio interest defined to exclude both interest paid to 10% Shareholder and interest paid to CFC from related person

- 10% Shareholder status based on voting power
- Since Non-US Co is now CFC, interest is taxable & subject to withholding



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"Everything a CFC": Historic Planning for "Global Families" Much Less Certain

- Trust for Benefit of Non-US/US Persons Structured to be "Foreign Grantor Trust"
  - Trust income during life of the Non-US Grantor deemed realized by Non-US Grantor and not Trust
    - Thus trust income distributed to US Beneficiary is non-taxable and considered a "gift" from grantor to beneficiary
    - No "build-up" for accumulated income (and thus no "throwback tax")
- Where Grantor Trust qualifies as "Revocable" under US Law, Benefits of Non-US Taxation to US Beneficiaries often extended – Election under IRC Section 645
- Revocable Trust aspect translates to need to "block" US Estate Tax for Grantor

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Election under IRC Sec. 645

- Permits trustee of "qualified revocable trust" and – if any – executor of related estate to make election to treat the "qualified revocable trust" as part of "estate" of decedent
  - Status continues for at least 2 years (maybe more)
- Benefit is that "DNI" of foreign estate does not include gains or non-US source income
  - Basis-step up for trust assets at death, and thereafter through churning of trust assets during Section 645 election period = free from US tax
  - Throwback rules inapplicable to accumulated non-DNI during period

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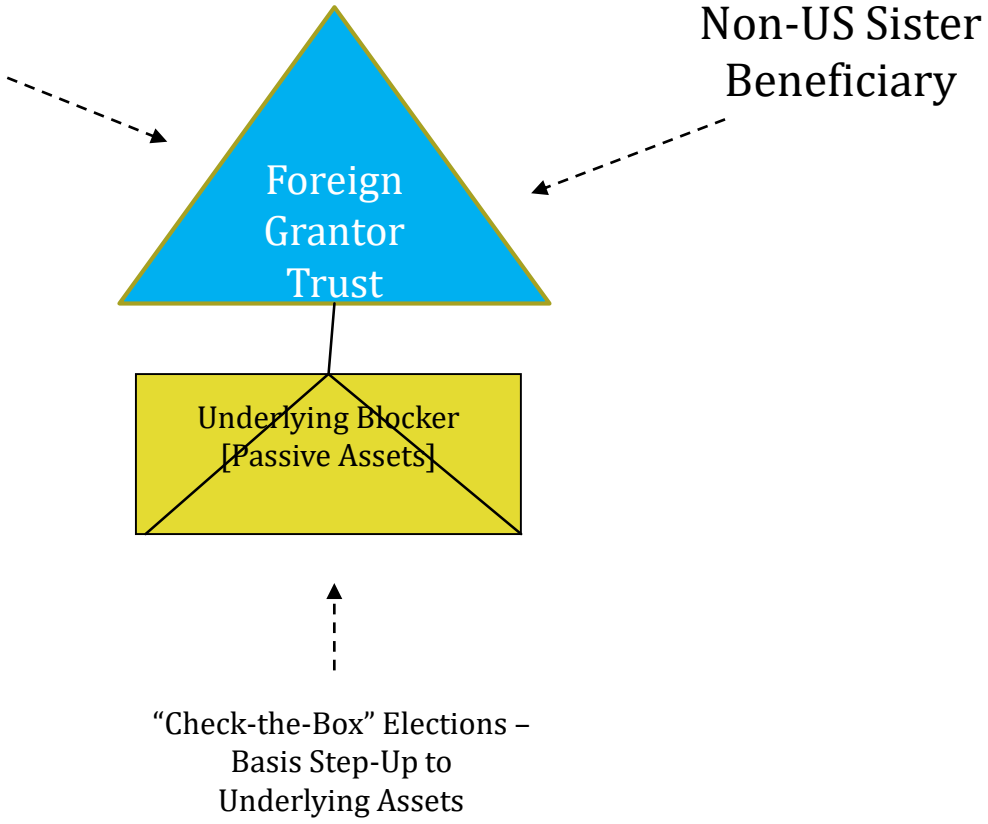
Section 645 Basis-Step Up

@ Death of Grantor: Elect to Treat Trust as Part of Grantor's Foreign Estate



- Blocker "blocks" US Estate Tax Exposure for Foreign Grantor
- Post-Death Election eliminated Corporate Status (and thus CFC Risk) to US beneficiary if made w/in 30 days of death
  - Income deemed realized within "estate"
  - Income = Foreign source gains excluded from DNI/UNI

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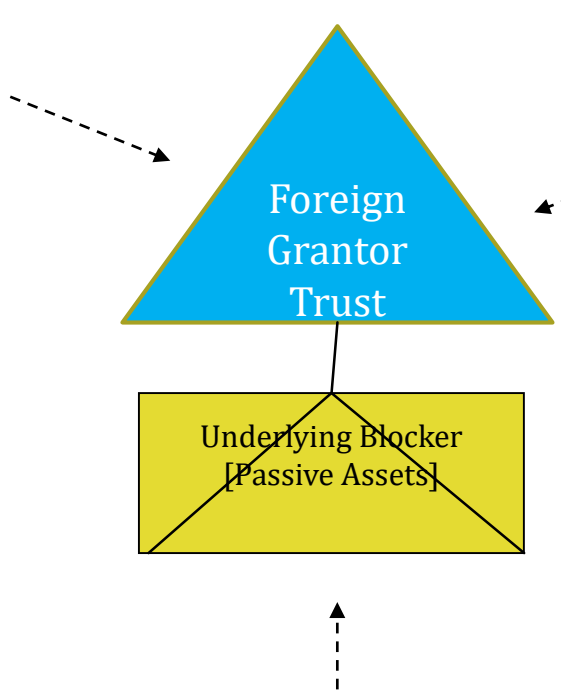
Section 645 Basis-Step Up: Now Subpart F Inclusion?

- No more 30 day "grace" period
- Immediately @ death, attribution from trust to beneficiaries
  - Is blocker a CFC?
  - Downward attribution from Sister to Brother
  - How treat "discretionary" trust/estate?
- If CFC, Subpart F inclusion for Brother attributable to Check-the-Box



Election Retroactive Prior to Grantor's Death Exposes Him to Estate Tax

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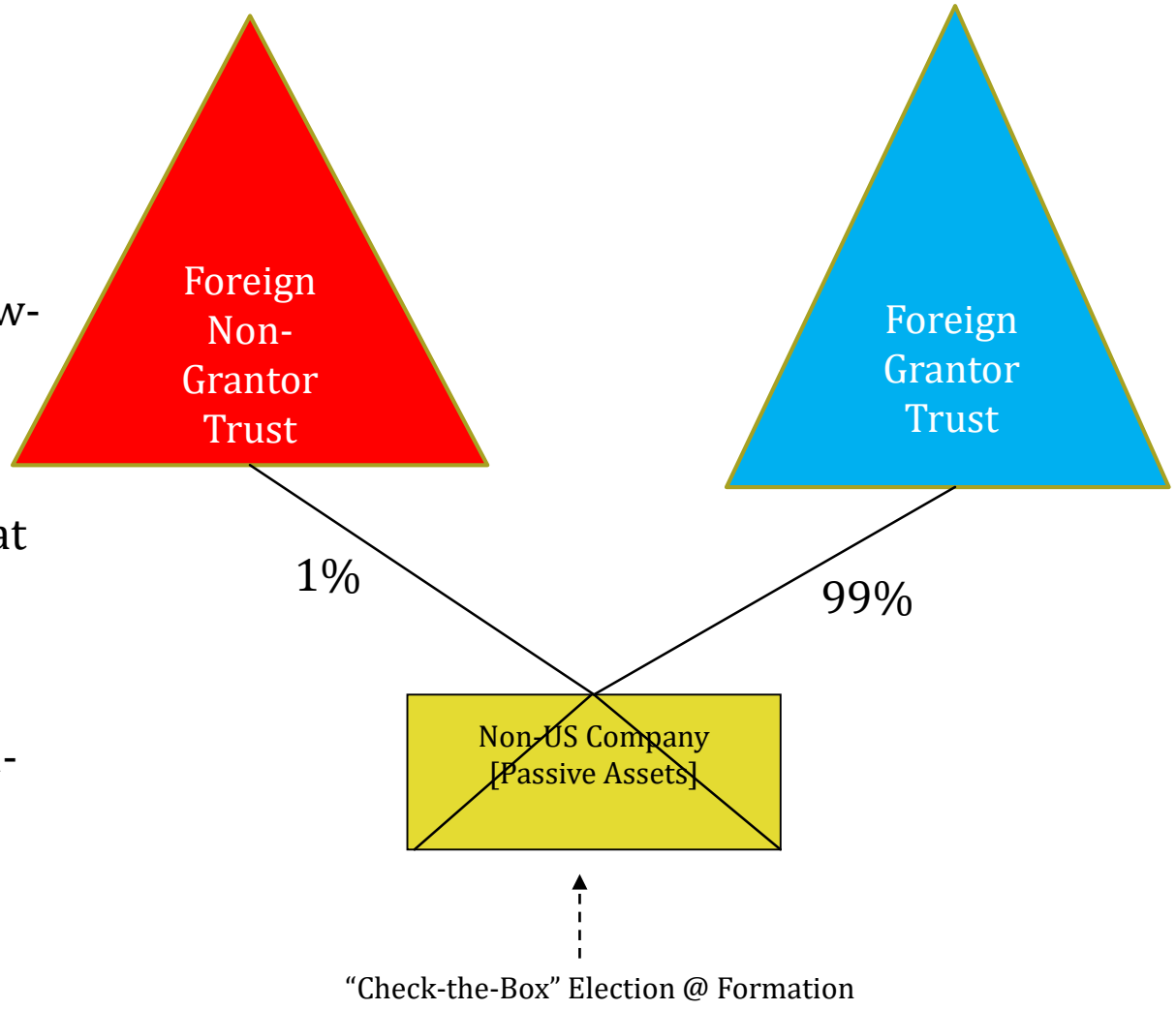
Now What?

- Multi-Member Non-US Flow-thru Entity as "blocker" for estate tax
  - No risk of CFC if elect non-corporate status at formation
  - Less certainty of US estate tax conclusion
- Portion attributable to non-grantor trust will risk DNI/UNI build-up



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New Tax Law incentivizes move to C Corporation

- Flow-through structures no longer as economically efficient in comparison
  - If "pass-through deduction" available, effective tax rates in the 30-35% range (depending); If not, 37%
  - State and local tax imposed at individual level, such that non-deductible
- C corporations taxed at 21%
  - State and local taxes fully deductible
  - "Shareholder Level" dividend taxed at 20%
  - "Combined" rate approximately 38.8%, assuming regular distribution

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C Corporation Benefits for Investment Income

- Flow-Through Effective Rates on Investment Income range from 20% to 37%, Without State Tax Deductibility
- Corporate Rate = 21% Plus State Tax Deductibility
- Keeping “assets in corporate solution” viable strategy again
  - Personal Holding Company Excise Tax Generally Manageable
  - Accumulated Earnings Excise Tax Generally Manageable

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Benefit of C Corporation Critical with Non-US Operating Income

- Two new tax regimes:
  - Global Intangible Low-Taxed Income or so-called "GILTI"
  - Foreign-Derived Intangible Income or "FDII"
  - Each of GILTI and FDII reduced by 10% of Adjusted Basis in Tangible Assets – Hence "Intangible"
- Gist of new regimes: *Impose Minimum Global Rate*
  - **If and only if** operate as C Corporation, federal tax rate of 10.5% (GILTI) and 13.125% (FDII)
    - 80% of foreign tax on operations creditable against GILTI, but not withholding tax
    - 100% of foreign tax (operations/withholding) creditable against FDII
    - Most State Tax System Exclude GILTI and FDII from C corporate income

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Pass-throughs Lose Benefits Under GILTI and FDII Regimes

- GILTI/FDII result in “rates” via deductions available only to C corporations
- Flow-throughs neither entitled deduction nor use of “indirect” (i.e., operating level tax) credits for Controlled Foreign Corporations
- Federal tax rate is thus 37% (or as low as 30% with pass-through deduction), compared to C rate of 10.5-13.125% (and 31.8% assuming distribution)

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New Tax Regime Creates Non-Taxed Pool of Income

- Portion of Non-US Net Income Excluded from US Tax
  - Such portion reduces GILTI/FDII
  - Portion = 10% of Adjusted Basis in Tangible Assets (i.e., Plant, Equipment, Furniture, Fixtures)
  - Income Exempt from Tax (Such that move to a "partial" territorial tax model
- Since GILTI/FDII is (basically) all foreign income in excess of above, incentive to build non-US manufacturing

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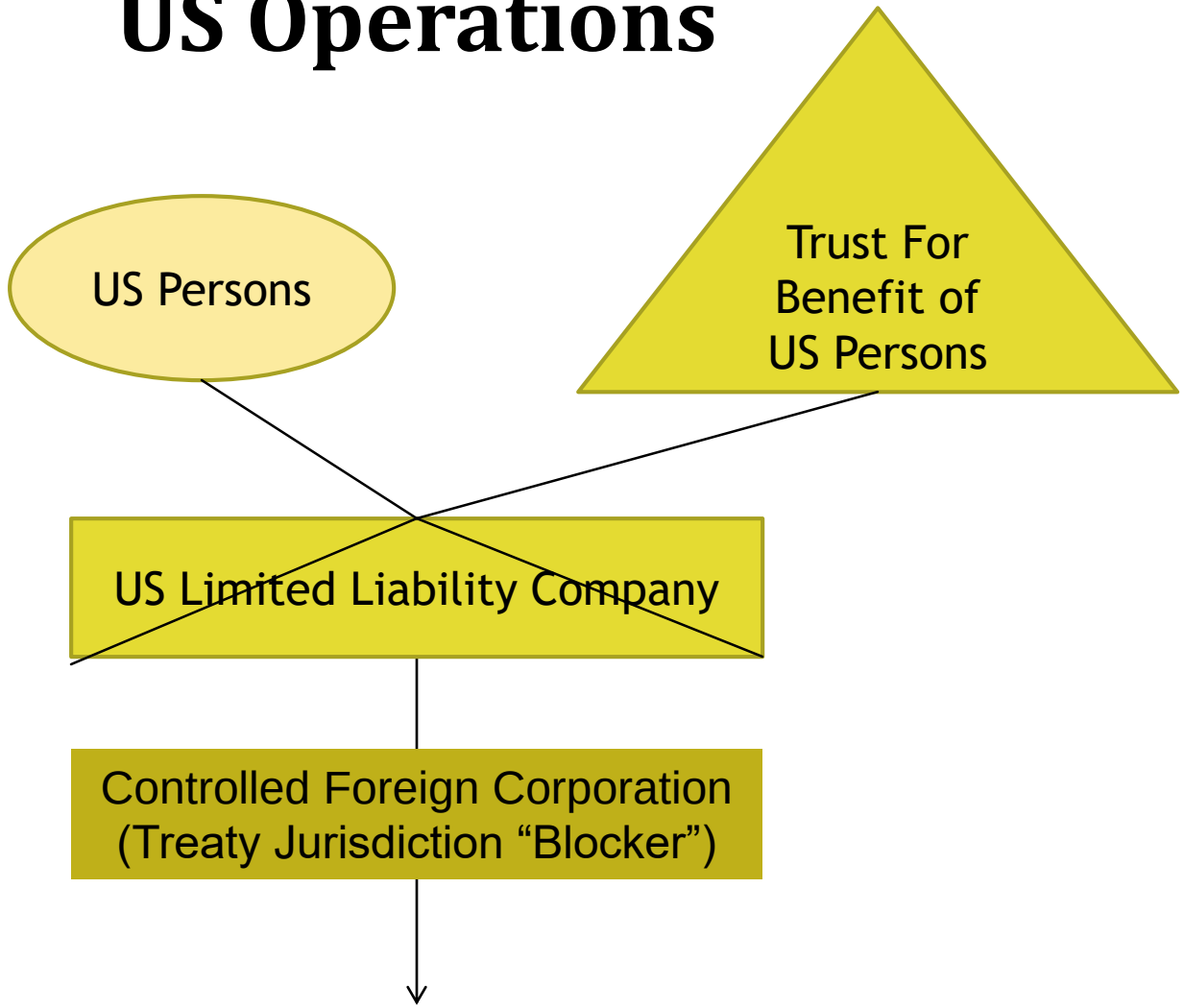
Structures Change for Non-US Operations

HISTORIC PLANNING



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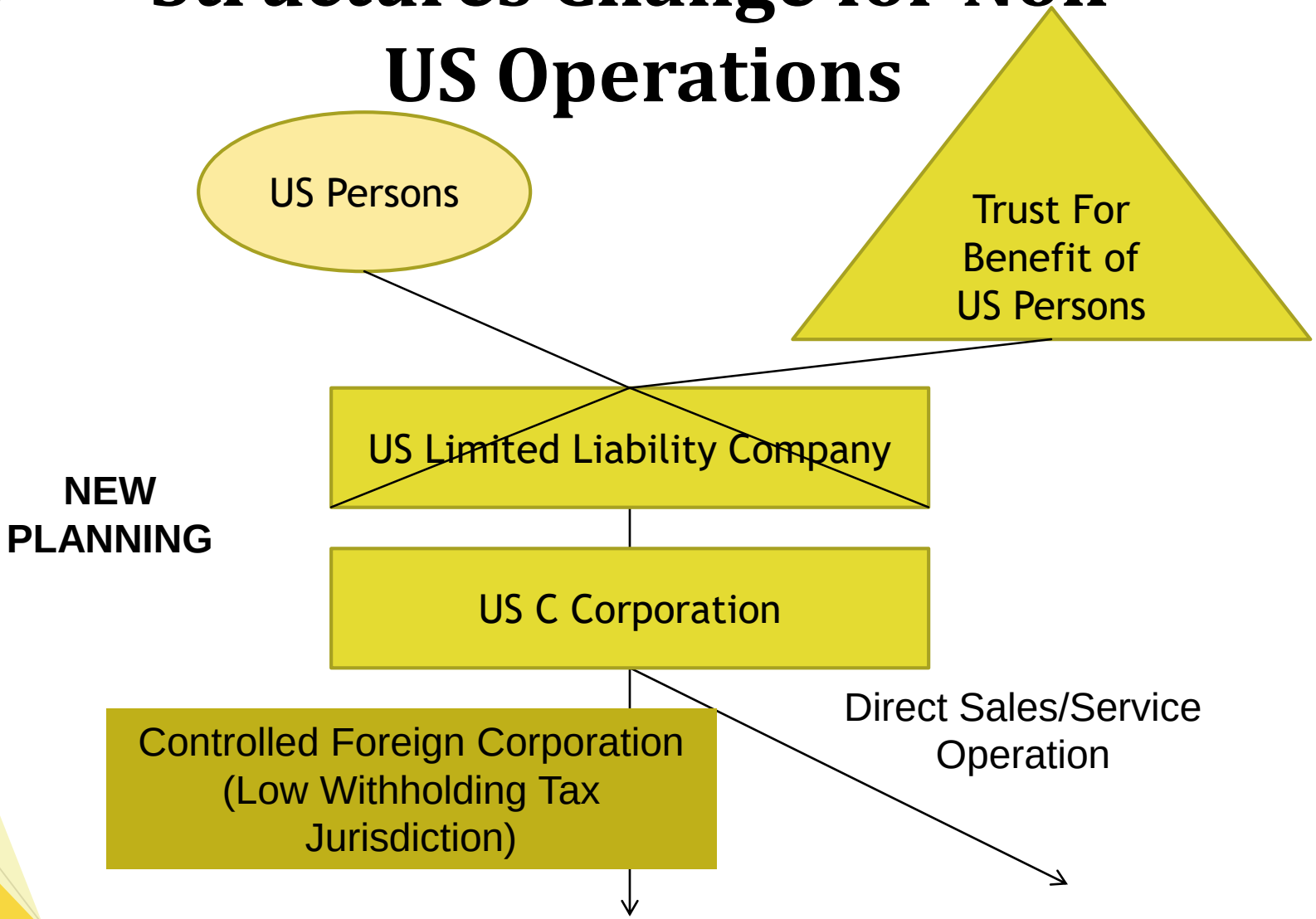
Structures Change for Non-US Operations



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New Limitations on Deductibility of Business Interest

- New IRC Section 163(j) limits deductibility of "business interest" expenses to an amount not exceeding the sum of taxpayer's business interest income and 30 percent of adjusted taxable income
- Business interest defined to mean all interest other than "investment interest" and real-estate-related interest for which special (irrevocable) election can be made.
- Interest expense exceeding this limit is not deductible in the current tax year but may be carried forward to subsequent years.
- An "electing real property trade or business" may elect to be excluded from these limitations. The election will require the business to change its cost recovery periods under the ADS.
- To be eligible for the election, taxpayer must be in a "real property trade or business" which includes real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. Does not include mortgage debt.

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New Limitations on Deductibility of Payments Involving Hybrids

- New IRC Section 267A disallows interest deductions for disqualified related-party amounts paid under a hybrid transaction or by or to a hybrid entity.
- Policy is to deny a deduction in the United States when a related non-U.S. recipient is not subject to tax on the item in its home country (I.e., Lux Preferred Equity Certificate Structures)
- The payment of interest/royalties = disqualified (nondeductible) if made between related parties where one of those parties is transparent in one jurisdiction but not in the other –a "hybrid entity"
  - Term "hybrid entity" would thus likely include a foreign grantor trust, but not non-grantor trust
  - Grantor trust is transparent for US tax but not likely transparent in jurisdiction of trust
  - Non-Grantor Trust is (likely) non-transparent in both jurisdictions

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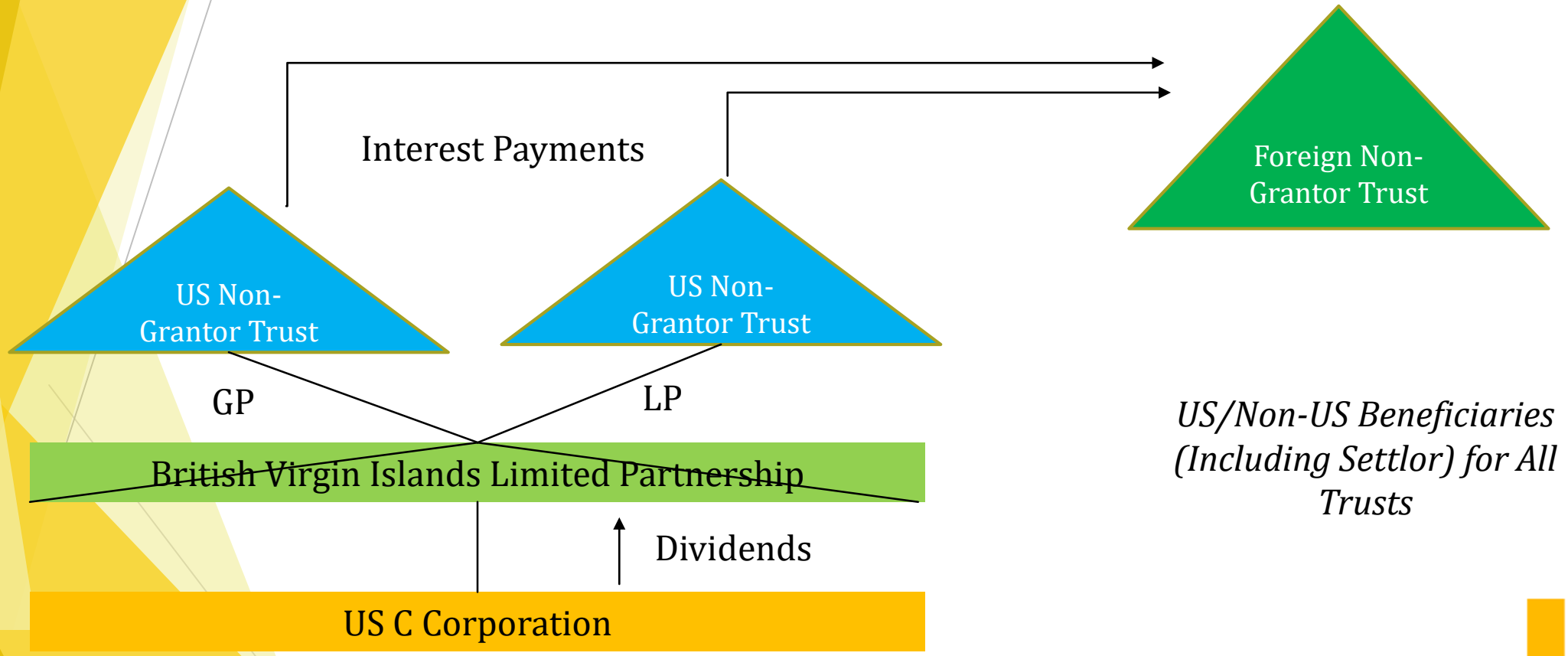
Revisions to Financing Models for Inbound Planning



US/Non-US Beneficiaries (Including Settlor) for All Trusts

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Deductibility of Investment Interest

- Unlike “business interest” which is now subject to limitations under IRC Section 163(j), “investment interest” remains deductible
- Limitation on deductibility = aggregate amount of “investment income”; carryforward for any excess
- Where dividends/gains on sale of US corporation shares considered “investment income”, interest is deductible against net
  - Special election [IRS Form 4952] required to treat dividend income/gains as investment income
  - May apply to all or any portion of dividends or gains
  - Election, once made, revocable solely with consent of IRS

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No Tax/Withholding for Interest Paid by Trust to Foreign Related Party

- IRC Section 871(h) generally imposes tax on interest paid to a foreign person unless interest is "portfolio interest"
  - Withholding by US payor required under IRC Section 1441
- Portfolio interest does not include interest paid by corporations or partnerships to a "10% Shareholder/Partner"
  - Attribution of ownership of shares/partnership interests between related parties
  - If interest were payable by US C Corporation or by Foreign Partnership, tax would be owing and withheld
- IRC Section 871(h) does not apply to obligations issued by trusts
  - Such interest paid is outside scope of statute

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Non-US Beneficiaries Should Find Domestic Trust Structure Efficient

- Domestic US Non-Grantor Trust is subject to tax on "distributable net income" retained in trust
  - Where investment interest is deductible against dividends/gains, reduction in DNI to zero is possible
  - Gains not included in DNI absent language to that effect in trust instrument or "reasonable application" of fiduciary discretion
  - DNI is deductible if actually paid to beneficiaries – i.e., not retained
- Distributions to beneficiaries "carry out" character of trust income so that beneficiaries pay tax (or not) depending on what income is included in DNI
  - If no "net" dividend income in trust but only gains, distribution of cash to non-US beneficiary may carry out gains to beneficiary
  - Since gains on sale of non-US shares is exempt from income, beneficiary avoids tax

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Estate Tax Inclusion Problem for Non-US Settlor Benefitting from Trusts

- Non-US Persons subject to US Estate Tax if "own" at least $60,000 of "US Situs assets" at death
- US Situs assets include shares in US Corporations
- All persons (foreign or domestic) deemed to own assets held in trust for their benefit if they settle those trusts and hold that beneficial entitlement at death (but nuances exist)
- Absent planning, non-US person settling US nongrantor trust for own benefit considered to own all US situs assets owned by trust – i..e, subject to US estate tax at death
- Thus need a "non-US blocker" to block out US estate tax – such a foreign partnership (not as ideal as historic planning)

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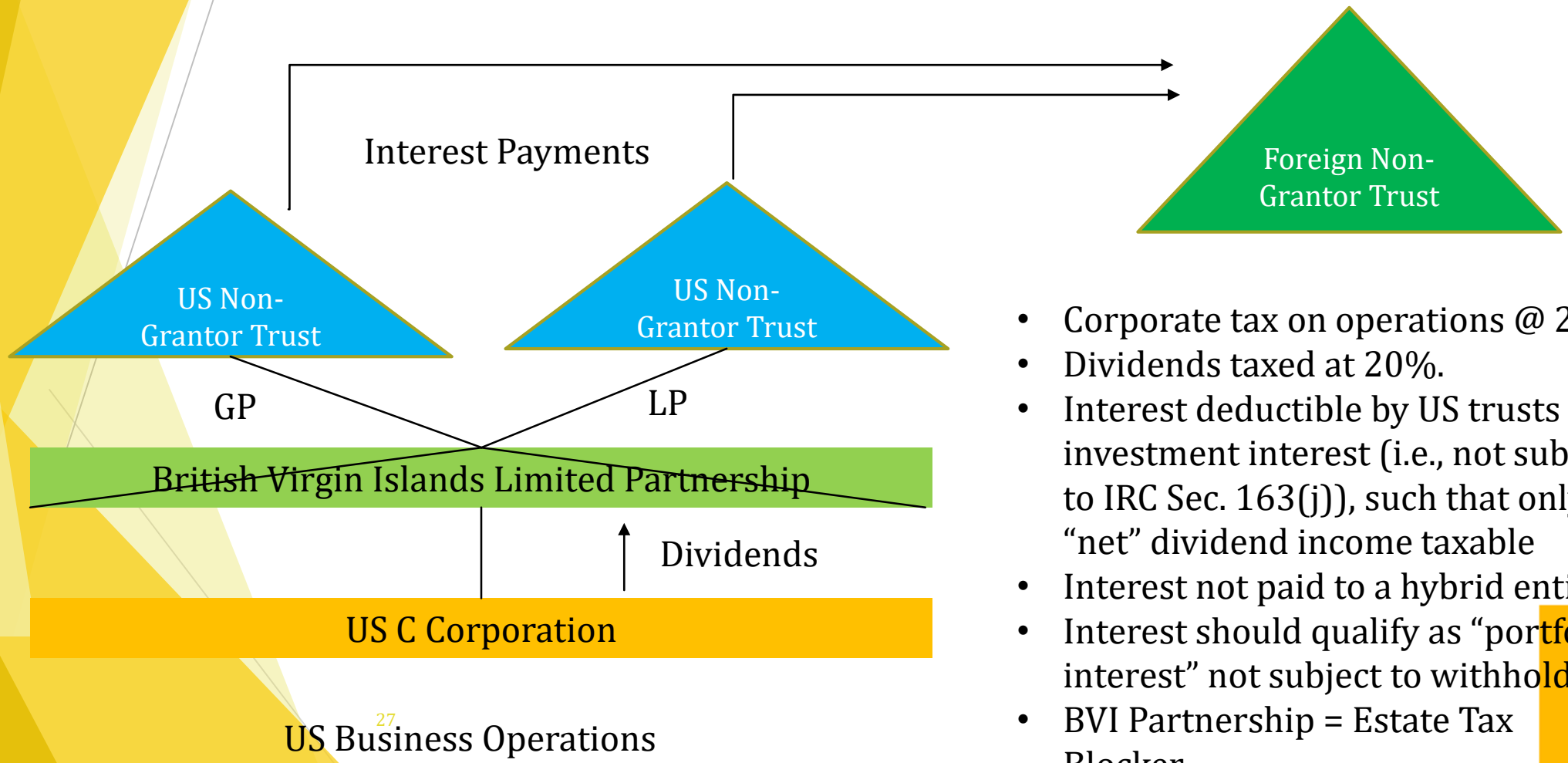
Revised Financing Model



- Corporate tax on operations @ 21%
- Dividends taxed at 20%.
- Interest deductible by US trusts as investment interest (i.e., not subject to IRC Sec. 163(j)), such that only "net" dividend income taxable
- Interest not paid to a hybrid entity
- Interest should qualify as "portfolio interest" not subject to withholding
- BVI Partnership = Estate Tax Blocker

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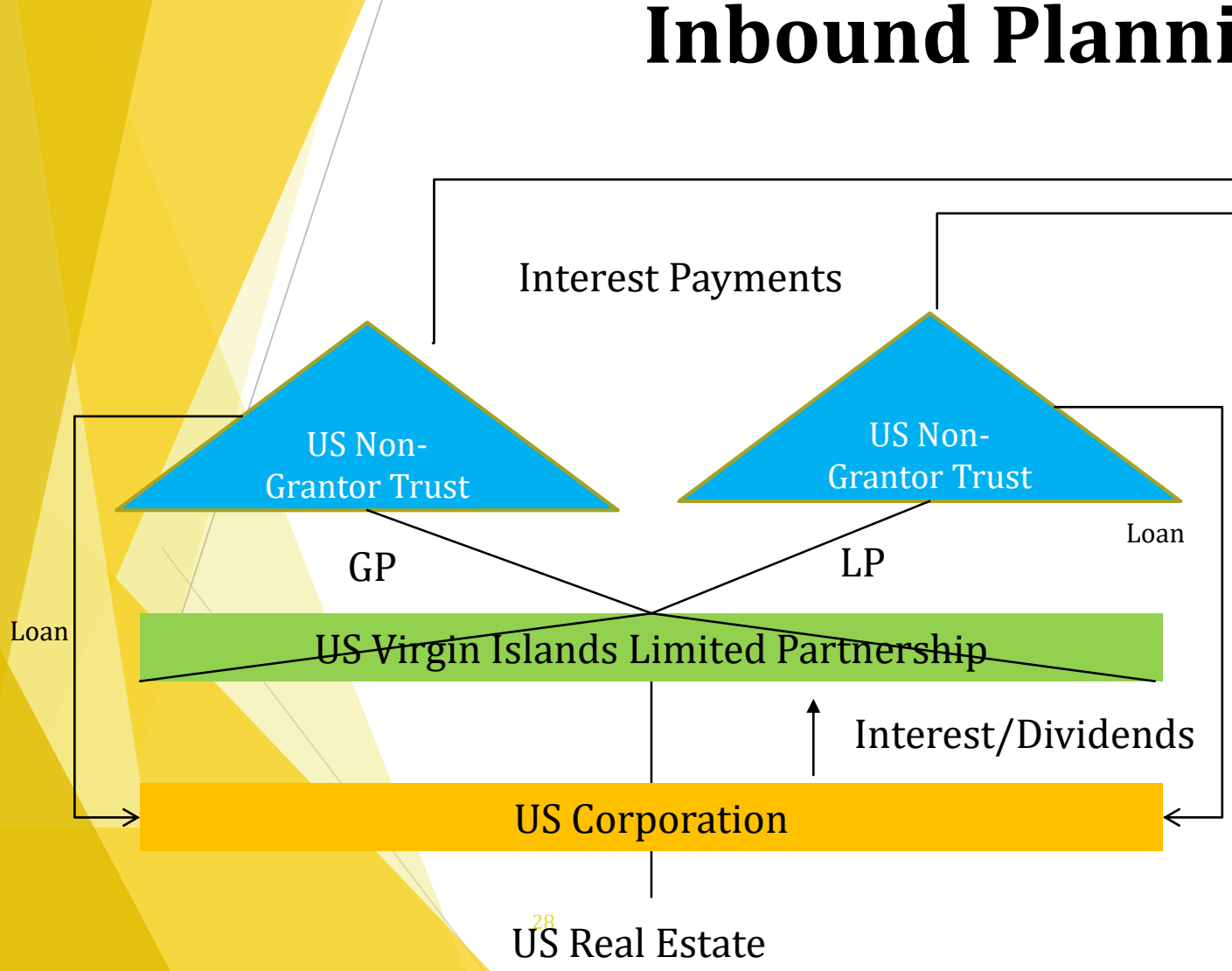
Improving Financing Model for Inbound Planning



- Corporate tax on net income (after deducting interest) @ 21%
- Interest & Dividends taxable to trusts at 20%.
- Interest deductible by US trusts as investment interest (i.e., not subject to IRC Sec. 163(j)), such that only "net" dividend/interest income taxable
- Interest not paid to a hybrid entity
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