U.S. Taxation of Non-U.S. Multinationals – Competing on a “Level” Playing Field

2018 U.S. Cross-Border Tax Conference

May 15 – 17, 2018

kpmg.com
Notices

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.
Agenda

01 U.S./Domestic issues
   — Is it worthwhile to increase U.S. investment?
   — Managing BEAT risk

02 Sandwich issues
   — Subpart F, GILTI, and FTCs
   — Should we think about out from under transactions?

03 Financing (163(j), hybrids)
## Today’s presenters

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Krisztina Rab</td>
<td>Director of Tax Planning &amp; International Tax, Robert Bosch LLC</td>
<td><a href="mailto:krisztina.rab@us.bosch.com">krisztina.rab@us.bosch.com</a></td>
</tr>
<tr>
<td>Kimberly Majure</td>
<td>Principal and National Inbound Leader, KPMG</td>
<td><a href="mailto:kmajure@kpmg.com">kmajure@kpmg.com</a></td>
</tr>
<tr>
<td>Luis (Lou) Abad</td>
<td>Principal, Washington National Tax – Trade &amp; Customs, KPMG</td>
<td><a href="mailto:labad@kpmg.com">labad@kpmg.com</a></td>
</tr>
<tr>
<td>Jeff Burns</td>
<td>Partner, State and Local Tax, KPMG</td>
<td><a href="mailto:jjburns@kpmg.com">jjburns@kpmg.com</a></td>
</tr>
<tr>
<td>Colleen O’Connor</td>
<td>Principal, Washington National Tax – Income Tax &amp; Accounting, KPMG</td>
<td><a href="mailto:colleenmoconnor@kpmg.com">colleenmoconnor@kpmg.com</a></td>
</tr>
<tr>
<td>Ulrich Schmidt</td>
<td>Managing Director, Global Location and Expansion Services, KPMG</td>
<td><a href="mailto:ulrichschmidt@kpmg.com">ulrichschmidt@kpmg.com</a></td>
</tr>
<tr>
<td>Kortney Wallace</td>
<td>Principal, International Tax, KPMG</td>
<td><a href="mailto:kdwallace@kpmg.com">kdwallace@kpmg.com</a></td>
</tr>
</tbody>
</table>
Brainiac Global Group – simplified org chart

Family Trust

Public

German Parent

50

50

Original Investor Trust

50 Class A shs

50 Class B shs

U.S. Parent

Dutch Fin/ HoldCo

German Ops

U.S. Ops

ROW Ops

Original German Co

Canadian and Mexican Ops

Swiss IPCo
## Tax reform – inbound considerations

### Snapshot of Tax Reform Considerations and Timing for Foreign Multinationals

<table>
<thead>
<tr>
<th>Immediate</th>
<th>Near Term</th>
<th>On the Horizon</th>
</tr>
</thead>
<tbody>
<tr>
<td>— Determine mandatory repatriation exposure</td>
<td>— Analyze related cross-border payments for BEAT purposes and restructure if necessary</td>
<td>— Consider supply chain in light of FDII and additional investment incentives</td>
</tr>
<tr>
<td>— Assess impact of rate drop for foreign CFC taxation and planning purposes</td>
<td>— Assess 163(j) (earnings stripping) exposure and, if necessary, refinance U.S. operations</td>
<td>— Evaluate optimal holding jurisdiction for IP</td>
</tr>
<tr>
<td>— Eliminate hybrid instruments as relevant</td>
<td>— Assess subpart F and GILTI exposure</td>
<td>— Consider “out from under” planning opportunities</td>
</tr>
<tr>
<td>— Identify additional compliance obligations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>— State and local filings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>— Form 5471 (more CFCs included)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>— Form 5472 (more data to be provided)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>— Customs</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
State IRC corporate and individual conformity

- No corporate or individual income tax
- Rolling conformity or conformity to current IRC (Alaska)
- Fixed Date or static conformity (Hawaii)
- State conforms only to specific sections of the code
- Corporate & individual Conformity Dates Diverge

Source: Federation of Tax Administrators
U.S./Domestic Issues
Brainiac Global Group – functional org chart

- **German Parent**
  - **U.S. Parent**
    - **U.S. Services Co**
      - **U.S. Software?**
        - Considering U.S. software development
      - **U.S. OpCos**
        - Mainly U.S. non-legacy IP
    - **U.S. IPCo (Nevada)**
  - **Dutch Fin. HoldCo**
  - **For OpCos**
    - **Swiss IPCo**
      - ROW non-legacy IP
        - Software development here
    - **Original German IPCo**
      - German legacy IP
  - **German Ops**
    - German group engaged in manufacturing and ROW sales of legacy products

- U.S. group engaged in import, manufacturing and North American sales
- U.S. Services Co provides mostly U.S. services but some product related services for North American sales

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
Trade policy trends that could significantly impact your trade and business strategy

Protectionist Pivot
- Campaign rhetoric to impose high tariffs on Mexico and China
- Withdrawal from TPP
- Withdrawal from Paris climate accord
- Threatened withdrawal from NAFTA and KORUS
- Executive Orders on trade matters
- Tax Reform
- G20 dropped endorsement of free trade / fighting protectionism

New Tariffs on U.S. Imports
- Section 201 safeguard tariffs (solar panels and washing machines)
- Section 232 national security tariffs (steel and aluminum)
- Section 301 potential unfair trade tariffs (proposed on 1,300 products)
- 20% tariffs (Canadian softwood lumber)
- 102 AD/CVD investigations from 1/20/17 through 4/4/18 (96% increase from prior period)
- First government-initiated AD/CVD action in 25 years

Potential Retaliatory Measures
- WTO Challenges
- Chinese tariffs on U.S. goods
- Trade War?

New Trade Laws and Increased Enforcement
- TFTEA 2015
- Sanctions (Iran, Korea and Russia)
- Expanded liability net

#KPMGXBB
Business incentives come in a variety of forms

- States and many local communities rely on business incentives to stimulate investment and economic development.
- Frequently, incentive agreements result in a “win-win” situation for both the company and the jurisdictions involved.
- Incentives often have a significant impact on a company's bottom-line when they are realizable and recognizable.
- Incentives can typically offset between 10-20% of investment costs.

**Statutory Tax Credits**
Established by jurisdictional statutes and are available “as of right” if qualifications are met.

**Discretionary & Negotiated Incentives**
Granting jurisdictions distribute incentives including cash and/or grants to approved projects. Skilled negotiations with granting jurisdictions can result in increased incentives.

**Tax Incentives**
- Property Tax Abatements (Real & Personal)
- Sales & Use Tax Exemptions or Refunds
- Corporate Income & Franchise Tax Credits
- **Other Tax Incentives**
  - Qualified Opportunity Zones
  - New Market Tax Credits
  - Tax Increment Financing (TIF, TIRZ, etc.)
  - Enterprise Zone, Foreign Trade Zone Benefits

**Non-Tax Incentives**
- Cash Grants
- Subsidized Real Estate
- Utility Discounts & Cost Offsets
- **Cost Avoidance**
  - Expedited Permitting
  - Infrastructure Incentives
  - Employee Training
  - Transportation Cost offsets
  - Security Assistance
  - Technology Assistance

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
FDII deduction accepted by states?

Some states require that corporate taxpayers begin the calculation of state taxable income with federal taxable income before the federal net operating loss and special deductions:

— **New Jersey**: The starting point for computing NJ taxable income “shall...be equal in amount to the taxable income, before net operating loss deduction and special deductions, which the taxpayer is required to report, ...to the United States Treasury Department for the purpose of computing its federal income tax…”

— **Tennessee**: “For a corporation..."net earnings" or "net loss" is defined as federal taxable income or loss before the operating loss deduction and special deductions provided for in 26 U.S.C. §§241, 242 [repealed], 243-247…”

Early reactions have been mixed:

— **Georgia**: “The deduction provided by Section 250 shall apply to the extent the same income was included in Georgia taxable net income.”

— **Idaho**: Requires the addback of amounts deduction under Code section 250.
Trade considerations for FDII

- Royalties paid by foreign affiliates / distributors – dutiable?
- Previously unrelated transactions become related party import transactions – arm’s length?
- U.S. export control compliance?
- Considered impact of higher tariffs?
- Duty drawback and FTZ benefits?
How to Manage BEAT Risk?
IP Cost-Sharing (Simplified Example)

BEAT Considerations:
- PCTs may offset each other (separately from offset of CSTs)
- Buy-in is BEAT-able, as U.S. Sub takes depreciation for contributed intangibles.
- Cost sharing payments received by U.S. Sub are applied *pro rata* against deductions associated with its development costs.
- Therefore, the $500 payment received reduces the $400 R&D and $600 other costs by $200 and $300, respectively. As a result, U.S. Sub has $200 ($400-$200) of BEAT-able payments.
- Consider having German Parent also sign the R&D services agreement and take on direct liability for payments, so that US Sub is (at worst) a payment agent.
- German Parent could also take responsibility for directly paying its share of R&D fees (reducing but not necessarily eliminating the BEAT-able amount).
COGS or Not?

1. Does the transaction involve a transfer of property (treated as a sale for tax purposes?)
   - No
   - Yes

2. Is the property transfer incidental to the contract (e.g., supplies?)
   - Yes
   - No

3. Is the taxpayer a producer of the property transferred (vs. reseller)?
   - Yes
   - No

4. Are the costs related to sale/distribution or post-sale activities (e.g., warranty services)?
   - Yes
   - No

5. Are these section 174 expenses?
   - Yes
   - No

6. Are the expenses related to sales based royalties?
   - Yes
   - No

7. Does the creative content rule apply?
   - Yes
   - No

8. Allocate btw. Ending Inventory and COGS

No COGS
Trade considerations for BEAT

- Restructure transactional arrangements and supply chains (part of COGS) and Identify any resulting increase to customs duty costs
- Implement mitigation strategies – first sale?
- Ensure import transactions are conducted at arm’s length
- Identify and manage customs compliance obligations
- Align COGS values for tax and customs purposes (1059A)
Sandwich issues
Brainiac sandwich structure
State treatment of current inclusions

Sample treatment of Subpart F

**California**: Does not adopt/conform to the Federal subpart F provisions. Permits a 75% DRD for dividends from certain foreign subs.

**Florida**: Subtracts from federal TI “all amounts included in taxable income under s. 78 or s. 951 of the Internal Revenue Code.”

**Michigan**: Permits subtraction from federal TI for “amounts determined under section 78 of the internal revenue code or sections 951 to 964 of the internal revenue code.”

**New Jersey**: No specific statutory rule. Administratively, the state applies its normal DRD rules to subpart F income from controlled foreign subs.

Sensitivities for Tax Reform rules?

**California**: Mandatory repat is not a subpart F inclusion and it’s not a regular dividend.

**Florida**: Does not cover section 965 or section 951A

**Michigan**: Does not cover section 965

**New Jersey**: Administrative practice is not precedential

---

*Is there a preference at the state level for subpart F income, as opposed to GILTI?*
## 5 ways to earn sandwich income

<table>
<thead>
<tr>
<th></th>
<th>Foreign Branch</th>
<th>CFC Sub F</th>
<th>CFC §956</th>
<th>CFC GILTI</th>
<th>CFC Other</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Residual U.S. tax rate</strong></td>
<td>21%</td>
<td>21%</td>
<td>21%</td>
<td>10.5%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Timing of Inclusion</strong></td>
<td>Current</td>
<td>Current</td>
<td>Current</td>
<td>Current</td>
<td>Deferred</td>
</tr>
<tr>
<td><strong>FTCs?</strong></td>
<td>Yes 100%</td>
<td>Yes 100%</td>
<td>Yes 100%</td>
<td>Yes 80%</td>
<td>No</td>
</tr>
<tr>
<td><strong>Mix with whose FTCs / what kind</strong></td>
<td>All U.S. group branches (GL/P)</td>
<td>All U.S. group (GL/P)</td>
<td>All U.S. group (GL/P)</td>
<td>USSH only for GL (“GILTI” basket) or P of U.S. group</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>FTC carryover permitted?</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Cover what income / earnings</strong></td>
<td>Current year income; current E&amp;P</td>
<td>Current FPHC (passive), FBC sales and services (GL); current E&amp;P only</td>
<td>Current U.S. investments, to the extent of current and accumulated E&amp;P (including otherwise “Other” earnings)</td>
<td>Current year income and E&amp;P</td>
<td>Allocated piece of USSH’s QBAI, high taxed dividends, etc.; applies to current and acc’d E&amp;P</td>
</tr>
</tbody>
</table>

#KPMGXB
5 ways to SALT a sandwich

State taxation requires multiple analyses:

— **Conformity/Non-Conformity:** Does the state adopt/conform to the Federal provisions.

— **Base Inclusion/Exclusion:** Does the state, by statute or otherwise, require inclusion or allow for exclusion of the items of income/deduction.

— **Partial Inclusion/Exclusion:** Would there be a partial inclusion or exclusion from the state income tax base related to state dividend rules.

— **Gross vs. “Net”:** Does the state allow for deductions under 965(c) or 250.

— **Apportionment Inclusion:** Does the state require the amount of income to be included in apportionment.
Simple upstream distribution

Tax Reform Considerations

— U.S. Subsidiary has gain on the distribution of CFC1 stock. Note, stock basis may have increased as a result of mandatory repatriation of CFC1 post-'86, untaxed E&P.

— Even if there is gain in CFC1 stock, treated as a deemed dividend to U.S. Subsidiary (and potentially 0% taxed under the new U.S. DRD) to the extent of untaxed post-'17 E&P. (Take the opportunity to create some?)

— Additional distributed value treated as a return of stock basis (non-taxable to U.S. Subsidiary). Any remaining excess, if any, is treated as capital gain and taxed to U.S. Subsidiary (21% rate).

— Low or no U.S. withholding tax per U.S.-Country X Treaty.

— Foreign Parent takes the dividend under the auspices of the Country X participation exemption.
Financing (163(j), hybrids)
Brainiac Global Group – interco financing arrangements

BEAT plus 163(j) issues

U.S. Parent

Dutch Fin/ HoldCo

Ire Co

German Parent

Can Co

$interest

Interest-free loan

Anti-hybrid issues?

#KPMGXBB
— FinCo provides an interest bearing loan ("IBL") to U.S. Co. Irish Co provides an interest free loan ("IFL") to FinCo.

— Ireland does not apply transfer pricing regulations, so interest income is recognized/adjusted at the level of Irish Co.

— FinCo jurisdiction does apply transfer pricing regulations and, as a result, FinCo has deemed interest expenses in respect of the IFL. FinCo is taxed on a spread between the IBL interest income and the deemed, IFL interest expense.

✅ Deduction/no inclusion or double deduction
N Hybrid instrument or entity involved
N 267A apply?
Belgian notional interest deduction

- Belgian NID Co licenses IP to U.S. Co.
- The royalty charged to U.S. Co is at arm’s length and actually paid.
- The Belgian Notional Interest Deduction regime (“NID”) permits Belgian NID Co to deduct a deemed interest expense (calculated based on the corrected equity of the company) from its taxable income.

<table>
<thead>
<tr>
<th>Country</th>
<th>Royalty</th>
<th>IP License</th>
<th>Deduction/no inclusion or double deduction</th>
<th>Hybrid instrument or entity involved</th>
<th>267A apply?</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Co</td>
<td>$ Royalty</td>
<td></td>
<td>✓</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Belgium NID Co</td>
<td></td>
<td>IP License</td>
<td></td>
<td>N</td>
<td></td>
</tr>
</tbody>
</table>

#KPMGXB
Thank you
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

NDPPS 613174

The KPMG name and logo are registered trademarks or trademarks of KPMG International.