Tax update for Corporate Treasurers

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International Tax Reform

Recent developments

Recent tax developments relevant to corporate treasury

Final OECD BEPS Package (October 2015)

- Interest deduction limitations (not minimum standard)
- Anti-hybrid provisions (not minimum standard)
- Double Tax Treaty abuse prevention
- Actions 8 to 10 (Transfer Pricing)

Draft EU Anti-Tax Avoidance Package (January 2016)

- Anti-tax avoidance directive
- Recommendation on tax treaties
- Country by country reporting
- External strategy for effective taxation
- Study on Aggressive Tax Planning structures

Further international developments

- US White Paper on EU State-Aid Investigations (24.08.2016)
- Apple State-aid ruling (30.08.2016)
- CCCTB (November 2016?)
- US / Ireland Treaty renegotiation
- US S.385 regulations

Final EU Anti-Tax Avoidance Directive (June 2016)

- Interest deduction limitations
- CFC rules in the EU
- Hybrid mismatch rules
- General anti-avoidance Rule ("GAAR")
- Exit taxation

Plus: Working paper on EU State Aid referencing financing companies

EU Anti Tax Avoidance Directive

Impact for corporate treasurers

The EU anti-tax avoidance directive – a brief overview

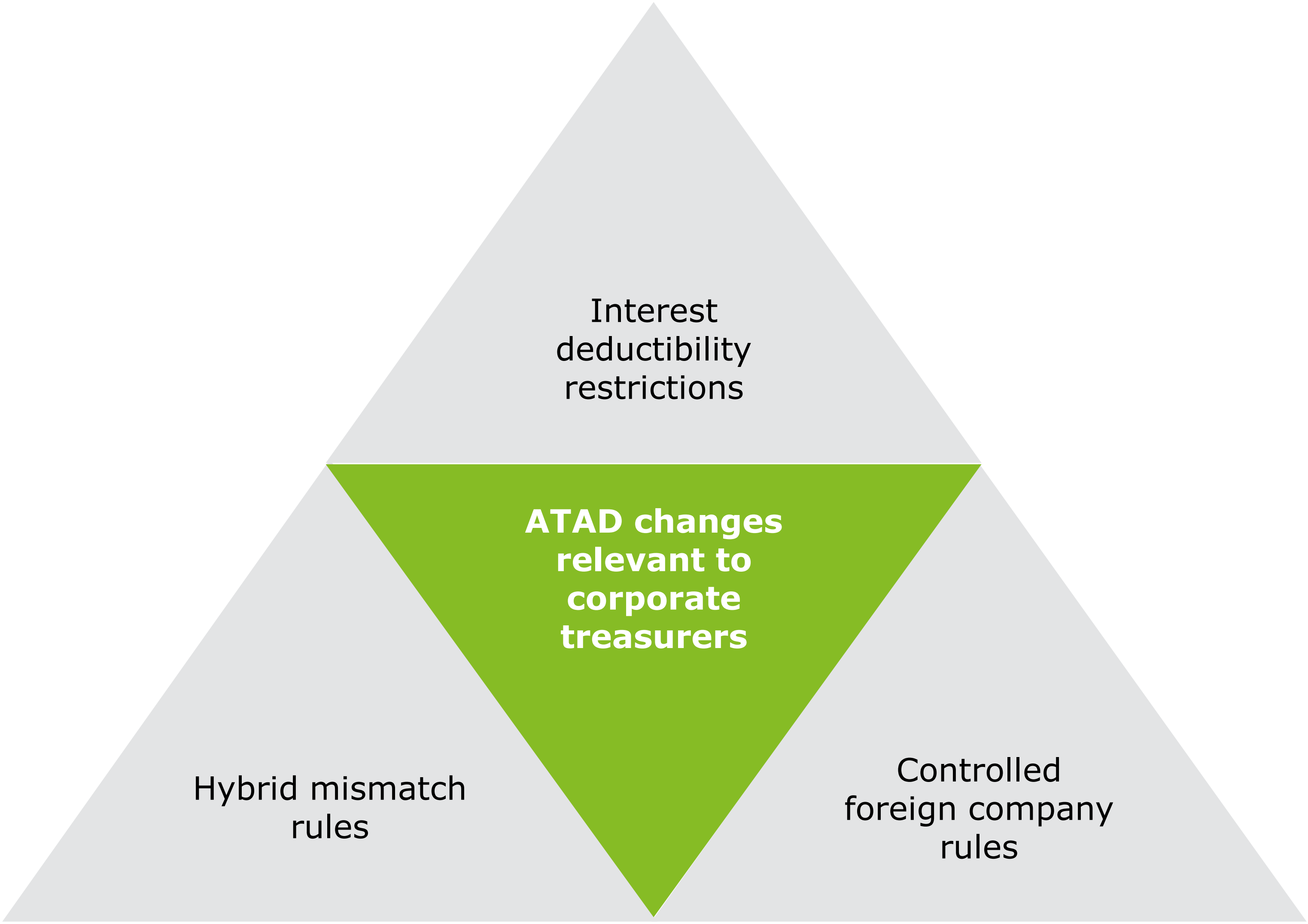
Entry into force 1 January 2019 (Exit Tax January 2020)

Planned directive proposal for hybrid mismatch rules with 3rd countries before the end of 2016

Interest restriction rules – delayed to 1 January 2024 (or, if earlier, when OECD reaches agreement on a minimum standard) if country has national targeted rules that are "*equally effective to the interest limitation rule*"

A number of mitigating options available to Member States on enactment into local law

EU ATAD
Changes of relevance to corporate treasury



Interest deductibility restrictions
Key points

1. Fixed ratio

- Net interest expense deduction limited to 30% of tax-adjusted EBITDA which must exclude tax-exempt income
- Disallowance is wider than just “interest” – includes finance lease, derivative instruments related to borrowings, certain FX gains / losses, guarantee fees, arrangement fees and similar costs related to borrowing
- Option to calculate on “group” basis - “group” for tax purposes in accordance with the country’s local tax laws

2. Possible reliefs

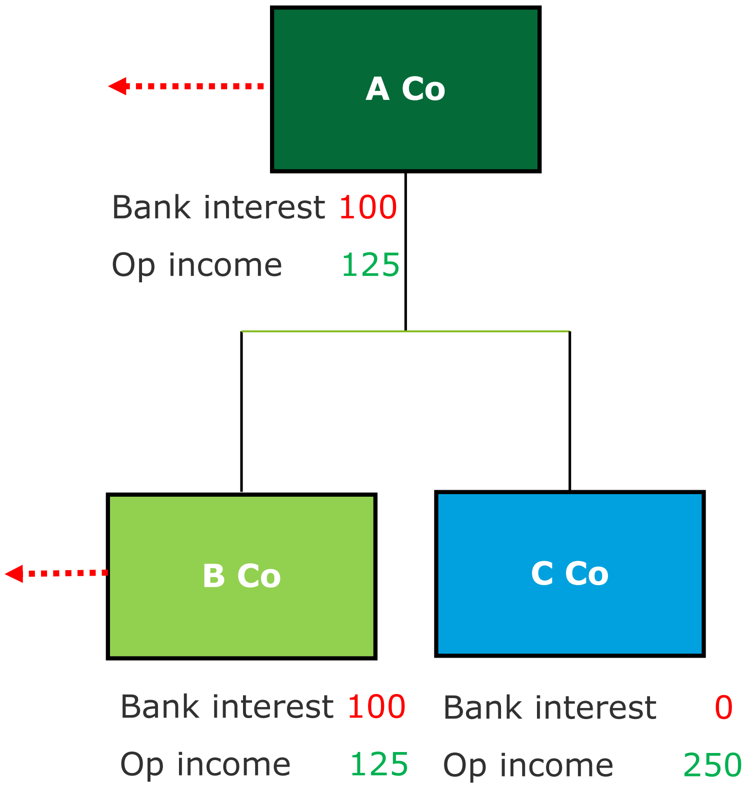
- Exclusion of stand-alone entities from the rules
- A deduction for interest up to €3million (calculated on a “group” basis – “group” for tax purposes)
- Full deduction where certain leverage ratios are in line with that of its consolidated group (“group” for accounting purposes)
- Exclusion of “financial undertakings” from the rules
- Unlimited carry-forward of capped interest and five year carry-forward of excess capacity
- Three year carry-back of capped interest
- Grandfathering of pre-17 June 2016 loans (subsequent modifications not grandfathered)
- Long term public infrastructure projects where lenders in the EU

In an Irish context, the proposed “interest” restriction in the ATAD would be wider than currently is the case in Irish law (in other words wider than only limiting the tax deduction to interest incurred by a company for trading or investment (s247) purposes).

But significant relief optionality means it might not be so bad after all…

EU ATAD impact for highly-leveraged operating companies

- Deduct interest expense up to 30% of tax-adjusted EBITDA



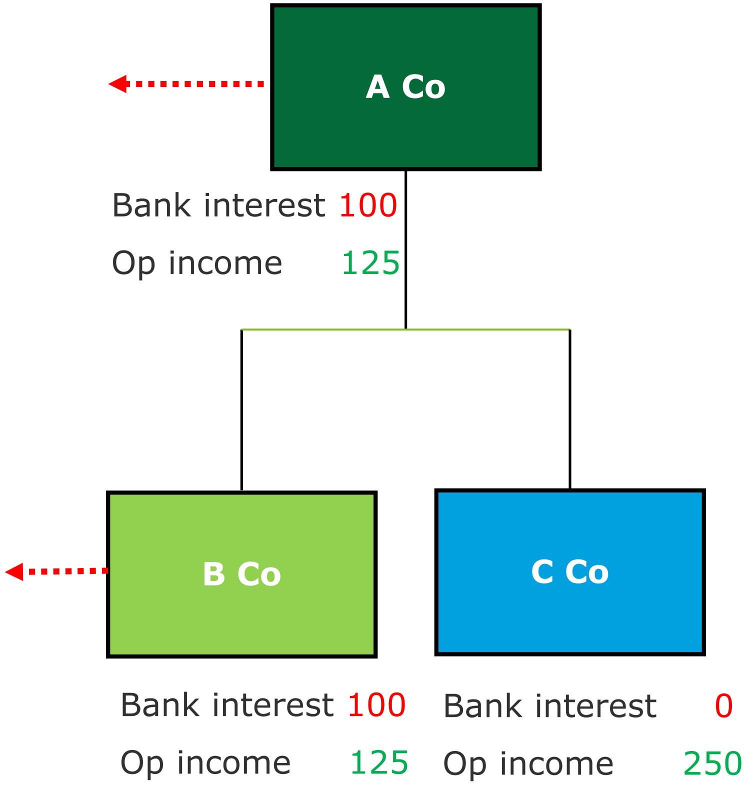
Group Interest to EBITDA ratio: 40%

Interest: EBITDA limit			**30%**
Deductible as follows:			
Co	Co Limit	Net Interest expense	Deduction allowed
A Co	38	100	38
B Co	38	100	38
C Co	76	Nil	Nil
	152	200	76

- **Interest disallowed under initial drafts = 124**
- **Under final ATAD group basis calculation may potentially reduce disallowance to 50 where all entities are within the same "group" for tax purposes under local tax law**
- **Disallowed interest is allowed to be carried forward for utilisation in future years**

Group-wide limitation example

- Increased deduction limit equal to 3rd party net interest to EBITDA ratio of the consolidated accounting group.
- Alternatively, full deduction if taxpayer can demonstrate that its equity to total assets ratio is in line with (2% deviation) or higher than the equivalent ratio of the consolidated group for accounting purposes.

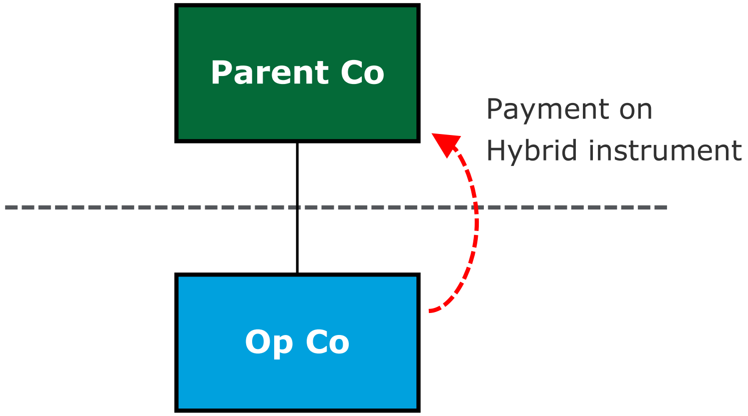


Group Interest to EBITDA ratio: 40%

Total interest deductible by group			**200**
Deductible as follows:			
Co	Group increased Limit (40%)	Net Interest expense	Deduction allowed
A Co	100	100	100
B Co	100	100	100
C Co	0	Nil	Nil
	200	200	0

- **Interest disallowed of 50 potentially decreases to 0 where all companies are in the same "group" for tax purposes and also in the same consolidated group for accounting purposes.**

Hybrid mismatches – Key points



Facts

- Parent Co holds shares in Op Co as well as a hybrid instrument e.g. Convertible Preferred Equity Certificate ("CPEC"), Repo, Profit Participating Loan ("PPL"), or others

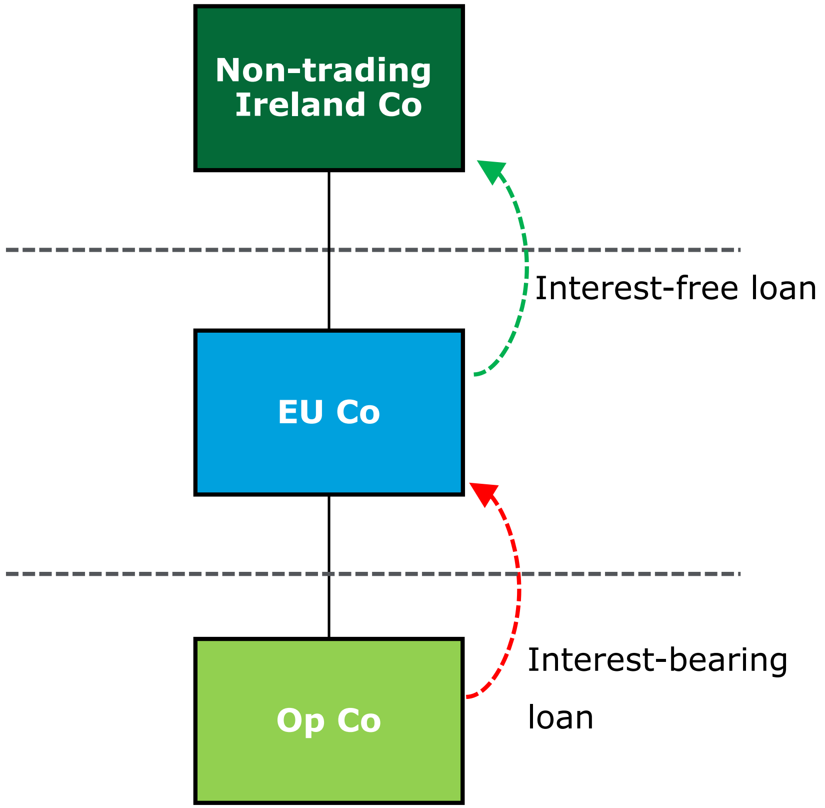
General tax consequences

- Deduction in Op Co for accrued interest expense under the hybrid instrument
- No taxation in Parent Co on income due to treatment of hybrid instrument as equity

EU ATAD response

- As the hybrid mismatch results in a deduction without inclusion, the Member State of the Op Co shall deny the deduction of such payment
- If it were the case that a hybrid mismatch results in a double deduction, the deduction shall only be given in the Member State where such payment has its source.
- Restricted to EU mismatches
- Aim is to extend to include non-EU mismatches as well

Interest-free loan structures



Facts

- Non-trading company advances interest-free loan to EU Co
- EU Co advances interest-bearing loan to Op Co

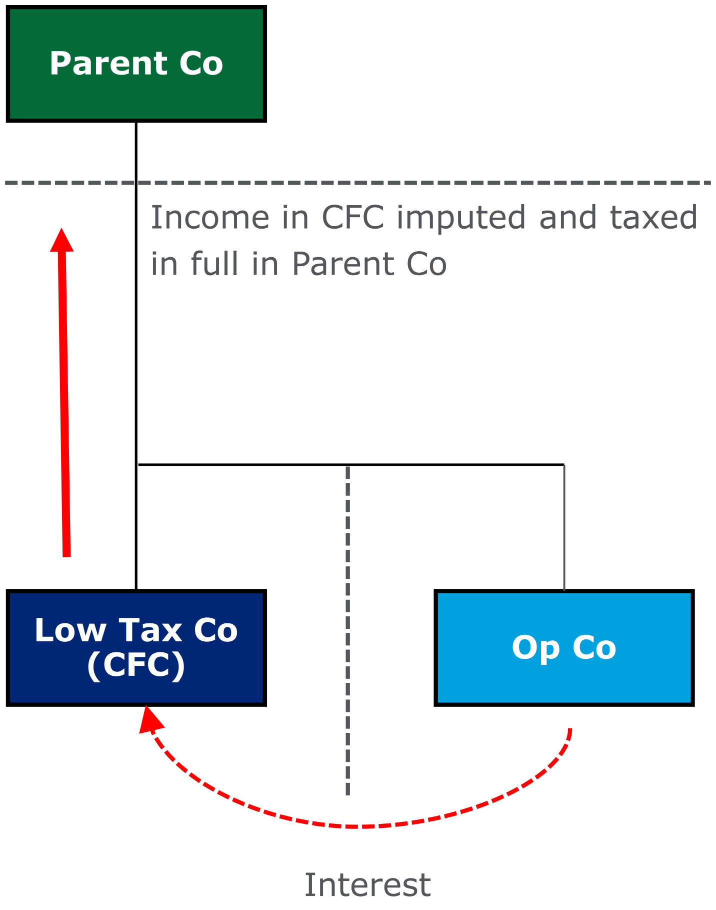
General tax consequences

- Op Co is entitled to a tax deduction for interest incurred on the interest-bearing loan
- EU Co is effectively entitled to a deduction equal to an arm's length rate of interest
- Ireland Co not taxable on any "deemed" interest income on the loan

EU response

- A mismatch in tax outcome appears to have arisen, but is it an unacceptable mismatch?
- EU Study of Aggressive Tax Structures (January 2016) and EU Working paper on EU State Aid makes specific reference to such structures.
- Changes in Irish tax law to address such structures possible

Controlled foreign company rules



Key Characteristics of proposed EU CFC rules

- >50% control test (direct or indirect) of companies or permanent establishments not taxed in the head office location of the Member State
- Company/PE taxed at <50% of the effective tax rate in parent company Member State.
- Two systems for determining inclusion of undistributed income of the CFC:
  - Undistributed income of CFC from defined categories (e.g. royalties, interest, dividends, income from banking, insurance and other financial activities etc.); or
  - Undistributed income of CFC from non-genuine arrangements (e.g. a CFC with no assets or bearing no risk)
- Ireland does not currently have any general CFC rules, but will be introduced with effect from 1 January 2019 under ATAD.
- Organisations with treasury/financing activities in Ireland will need to ensure substantive economic activities are actually undertaken in Ireland.

Ireland-US double tax treaty

Impact for corporate treasury

Ireland-US double tax treaty changes
Key points to note

Background

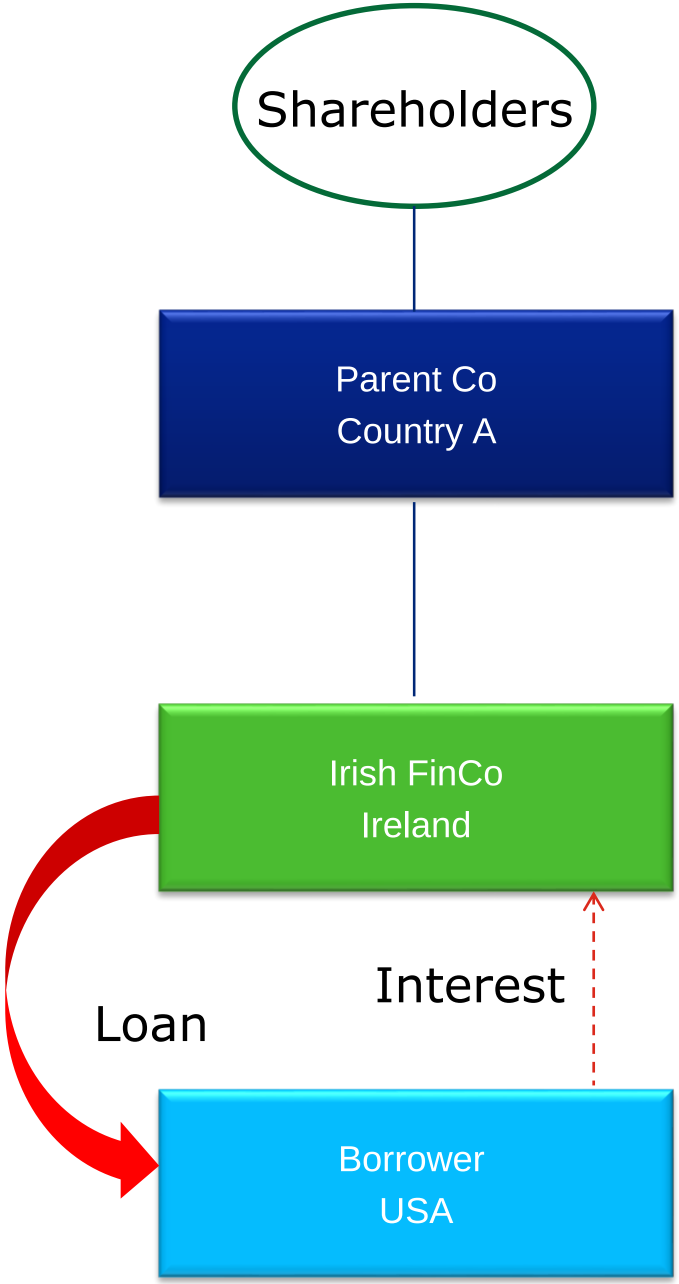
- 26 August 2016 – Department of Finance announce discussions begun to update treaty based on revision to US Model Income Tax Treaty and to take account of OECD BEPS project
- Public consultation on current Ireland-US treaty and 2016 US Model Treaty until 14 October 2016 (IACT currently preparing submission)

Some key changes to note

- Significant changes to Limitation on Benefits clause
  - Publicly-traded test
  - Active trade or business test*
  - Intermediate owners
  - Anti-base erosion test
- Subsequent changes in law provision
- Special tax regimes* (interest paid to connected S.110s may be subject to US WHT)
- Triangular permanent establishment
- Dispute resolution

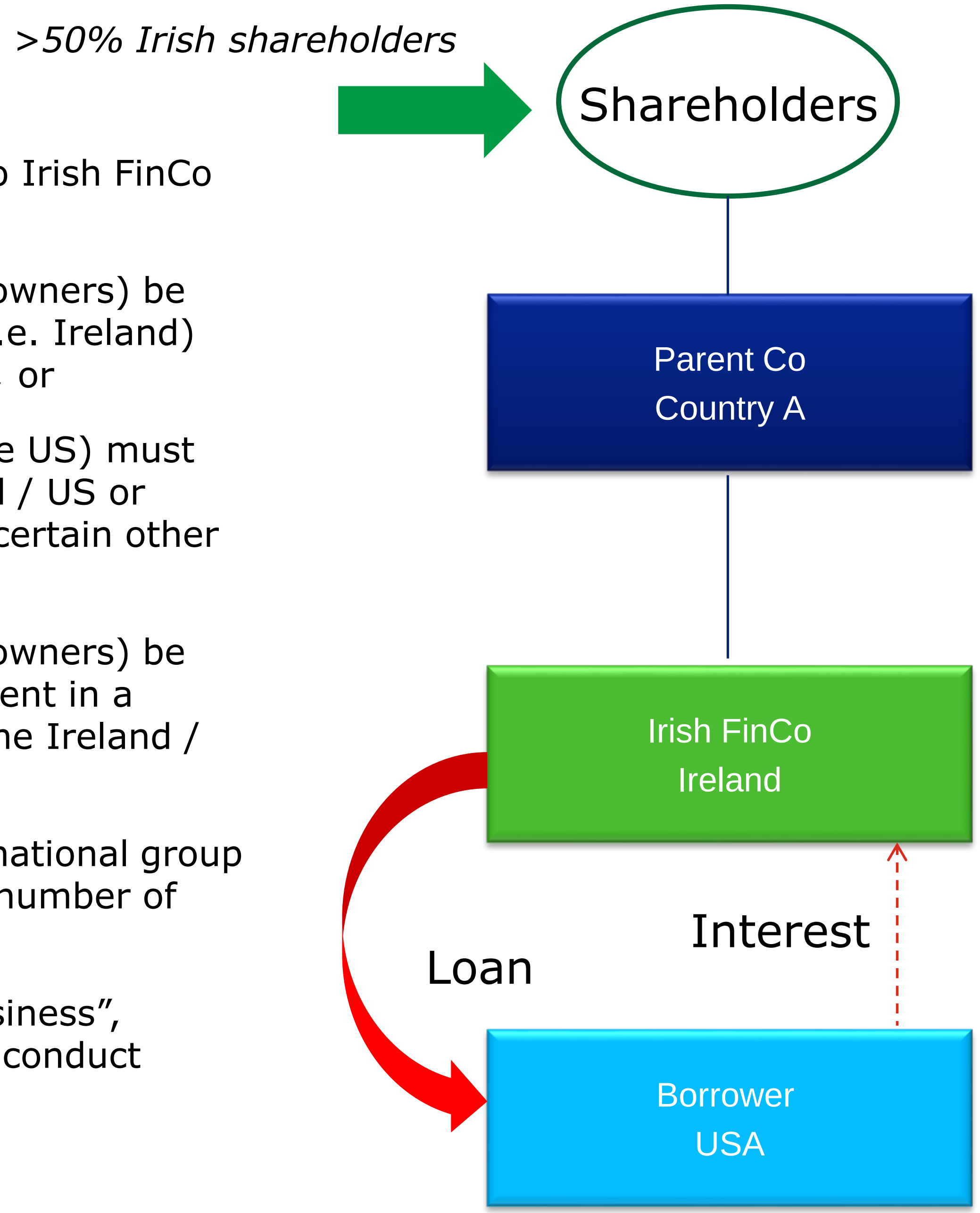
Ireland / US Double Tax Treaty changes
Article 22 – LOB clause

- Treaty benefits (e.g. exemption from WHT on interest) afforded to Irish FinCo if, for example:
  - Irish FinCo must ultimately (through qualifying intermediate owners) be owned >50% by persons tax resident in that same country (i.e. Ireland) that are entitled to benefits and must meet base erosion test; or
  - Shares in Irish FinCo (or Parent Co if resident in Ireland or the US) must be regularly traded on a recognised stock exchange in Ireland / US or “primary place of management” must be in Ireland / US and certain other requirements are met; or
  - Irish FinCo must ultimately (through qualifying intermediate owners) be 95% owned by a small number of investors who are tax resident in a country that provide essentially the same treaty benefits as the Ireland / US Double Tax Treaty; or
  - Irish FinCo functions as a headquarters company for a multi-national group (primary place of management and control in Ireland, plus a number of other requirements)
  - Irish FinCo is engaged in the “active conduct of a trade or business”, meaning, broadly, persons through whom the entity is acting conduct substantial managerial and operational activities in Ireland.



Ireland / US Double Tax Treaty changes

Article 22 – LOB clause



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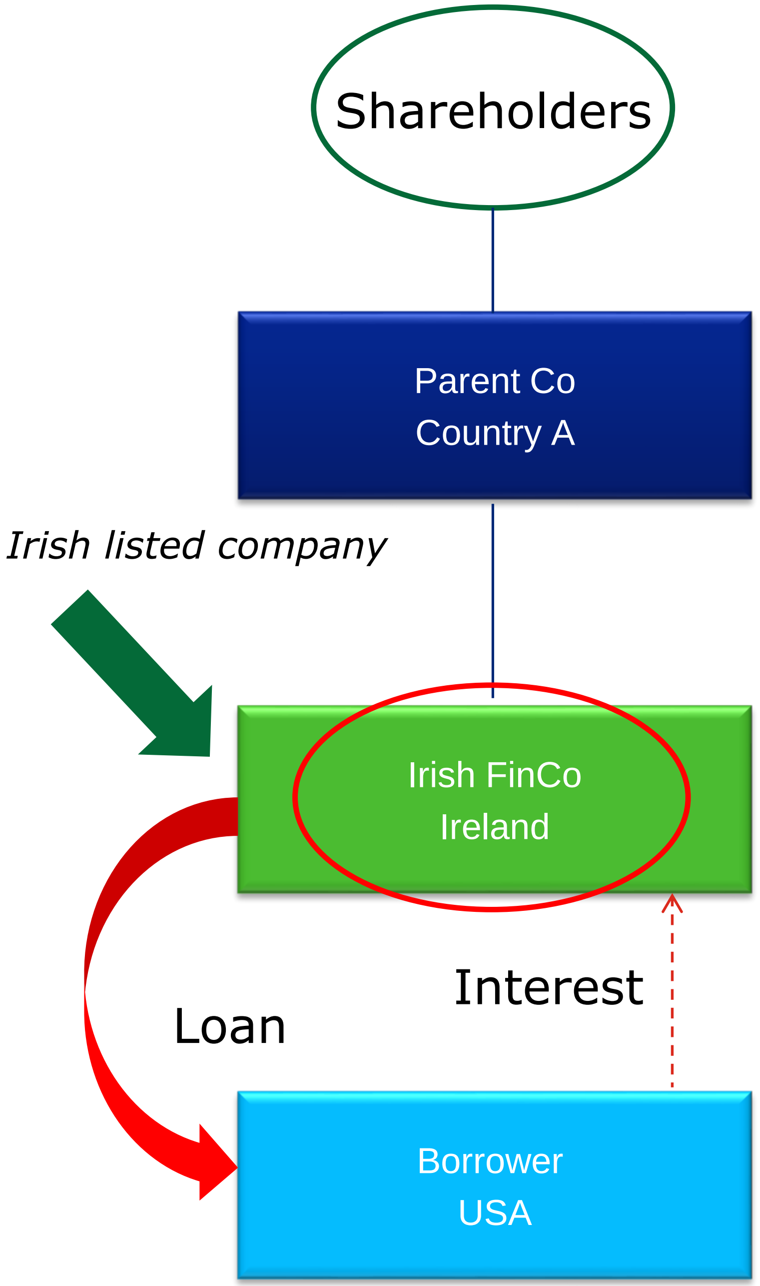

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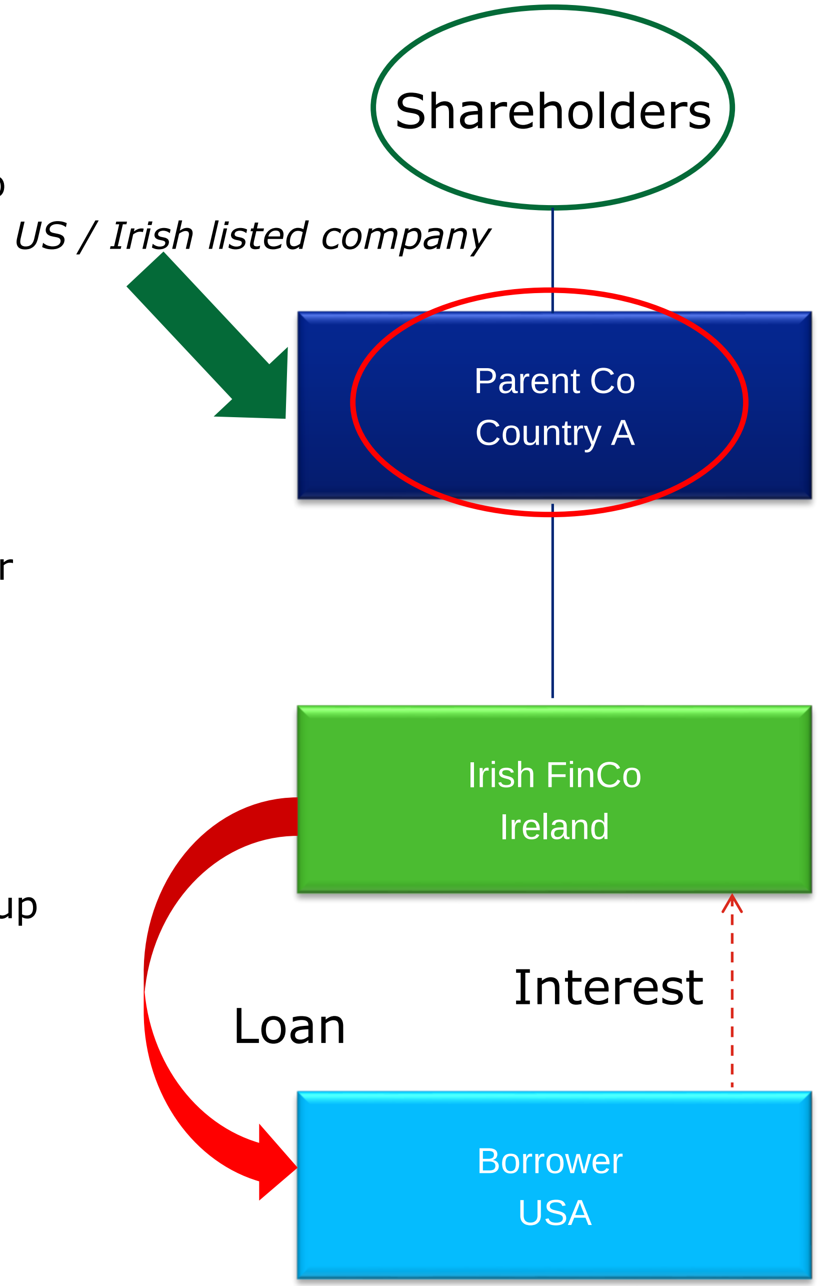

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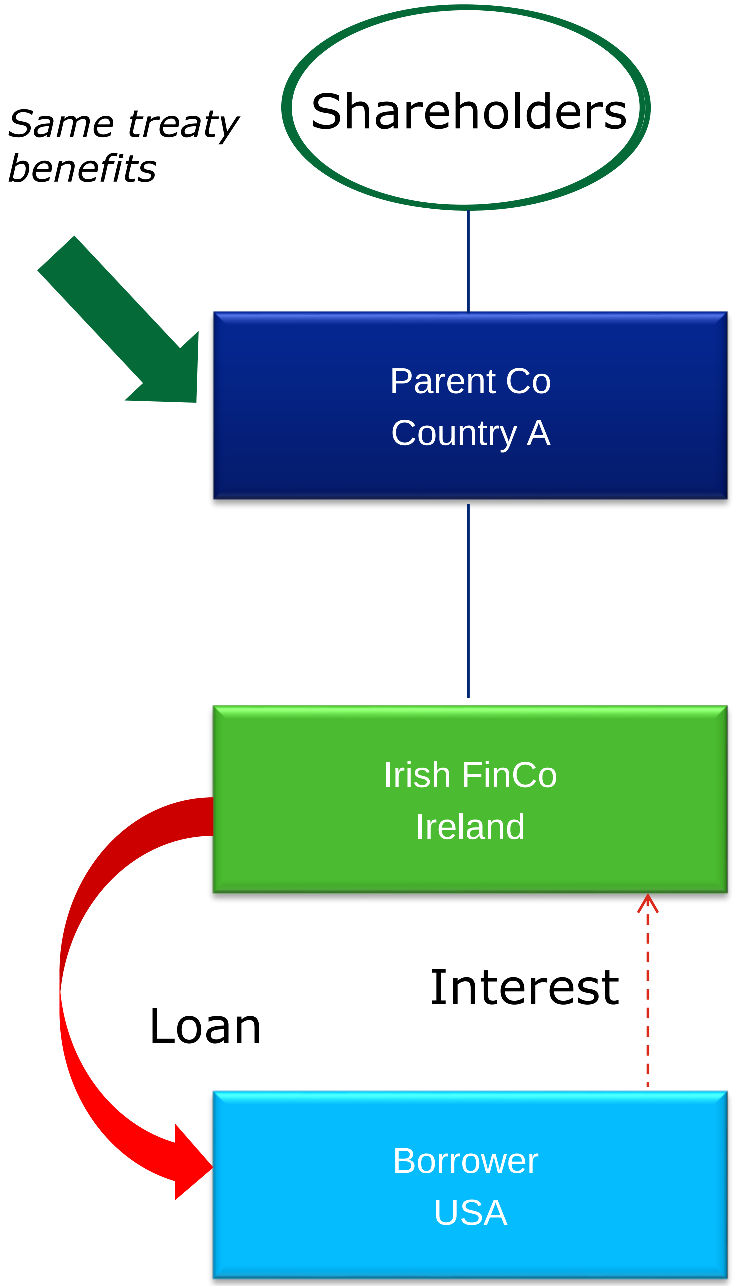

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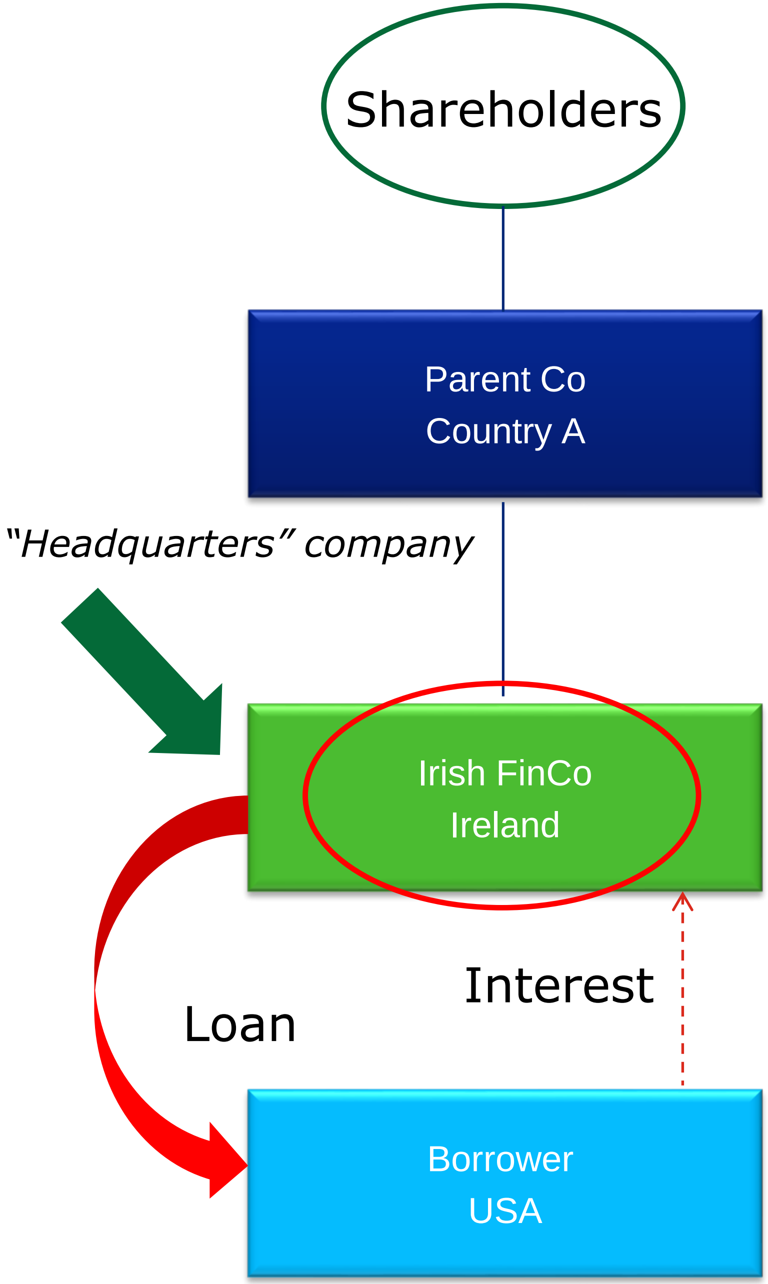

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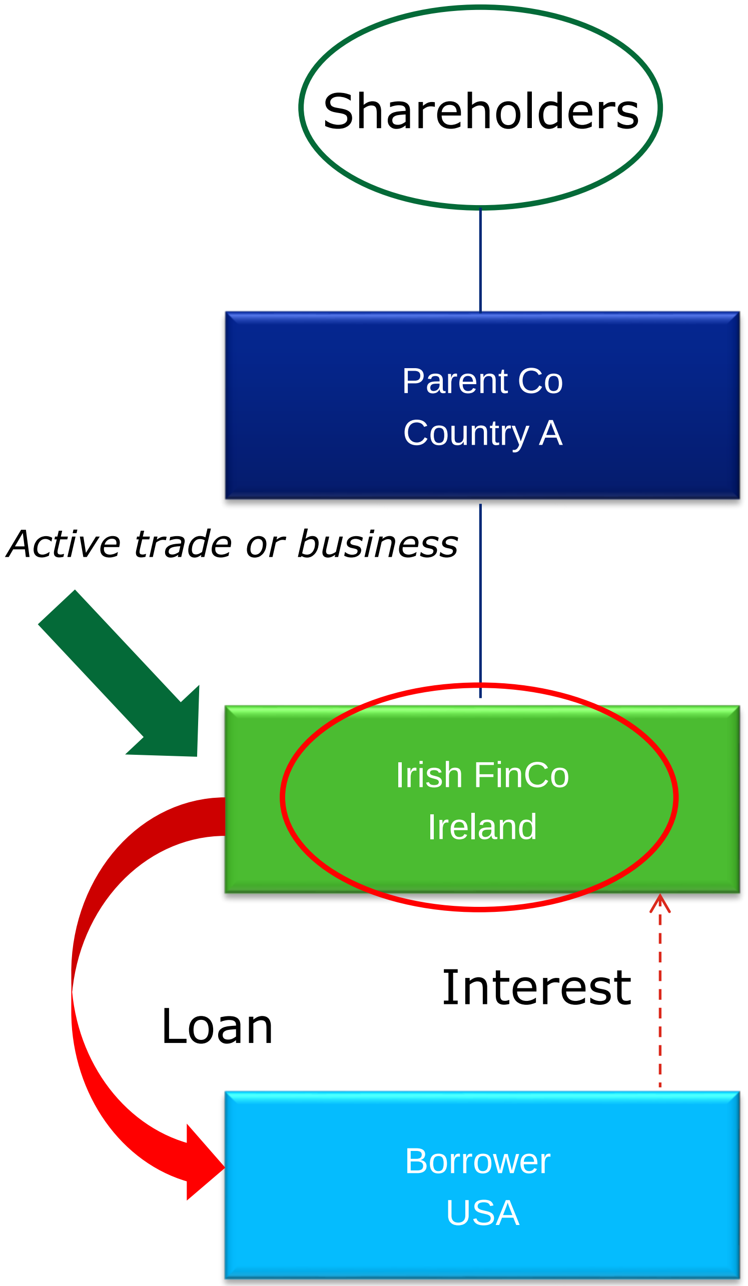

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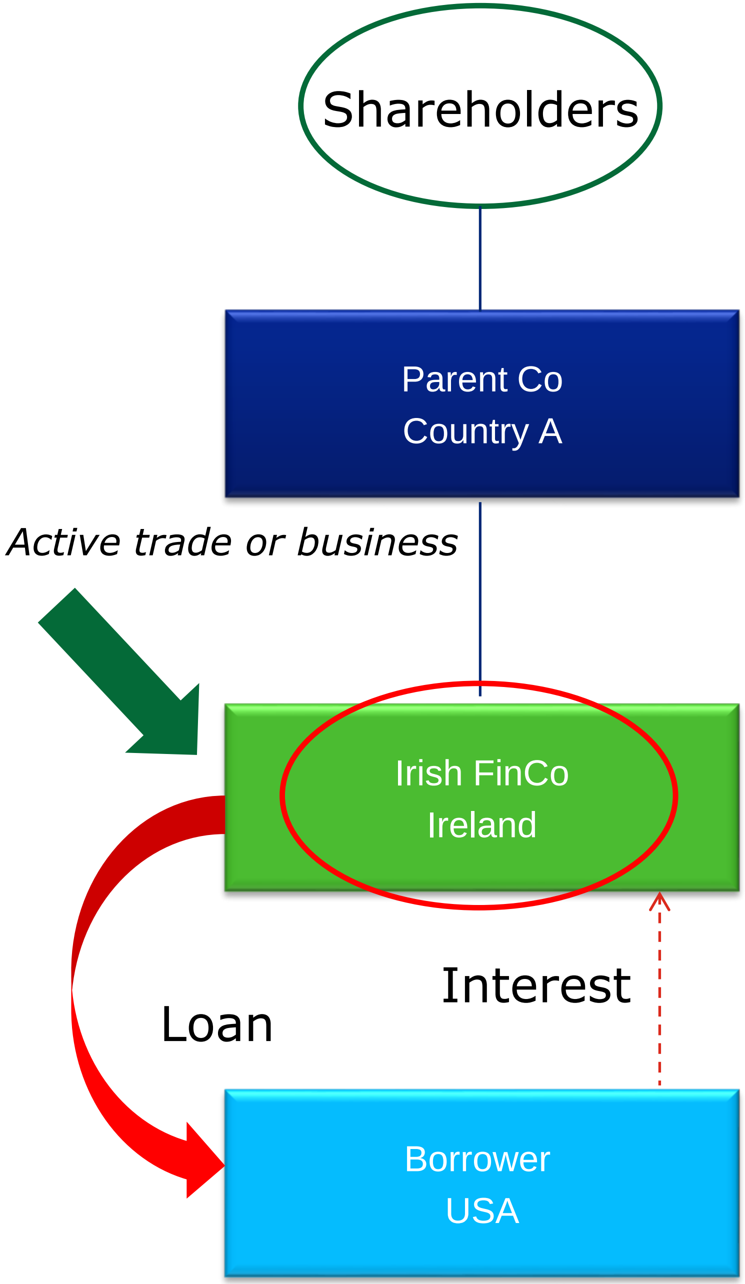
  - Irish FinCo is engaged in the "active conduct of a trade or business", meaning, broadly, persons through whom the entity is acting conduct substantial managerial and operational activities in Ireland. However, "active conduct of a trade or business" does not include "…providing group financing (including cash pooling)"



Key takeaways

- EU ATAD will impact interest deductibility and intergroup financing structures, but in many cases impact not nearly as severe as initially anticipated
- Substantive economic activity will become essential in jurisdictions where treasury / group finance companies are situated
- In future, based on current wording, it will be more difficult for Irish treasury / finance companies in non-US listed groups to receive interest from the US free from WHT
- More changes and developments are on the horizon