Moving ahead together

Legal entity simplification

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Agenda

Who could benefit from legal entity simplification (“LES”)?

Costs and risks of a complex structure

Recommended approach to legal entity simplification

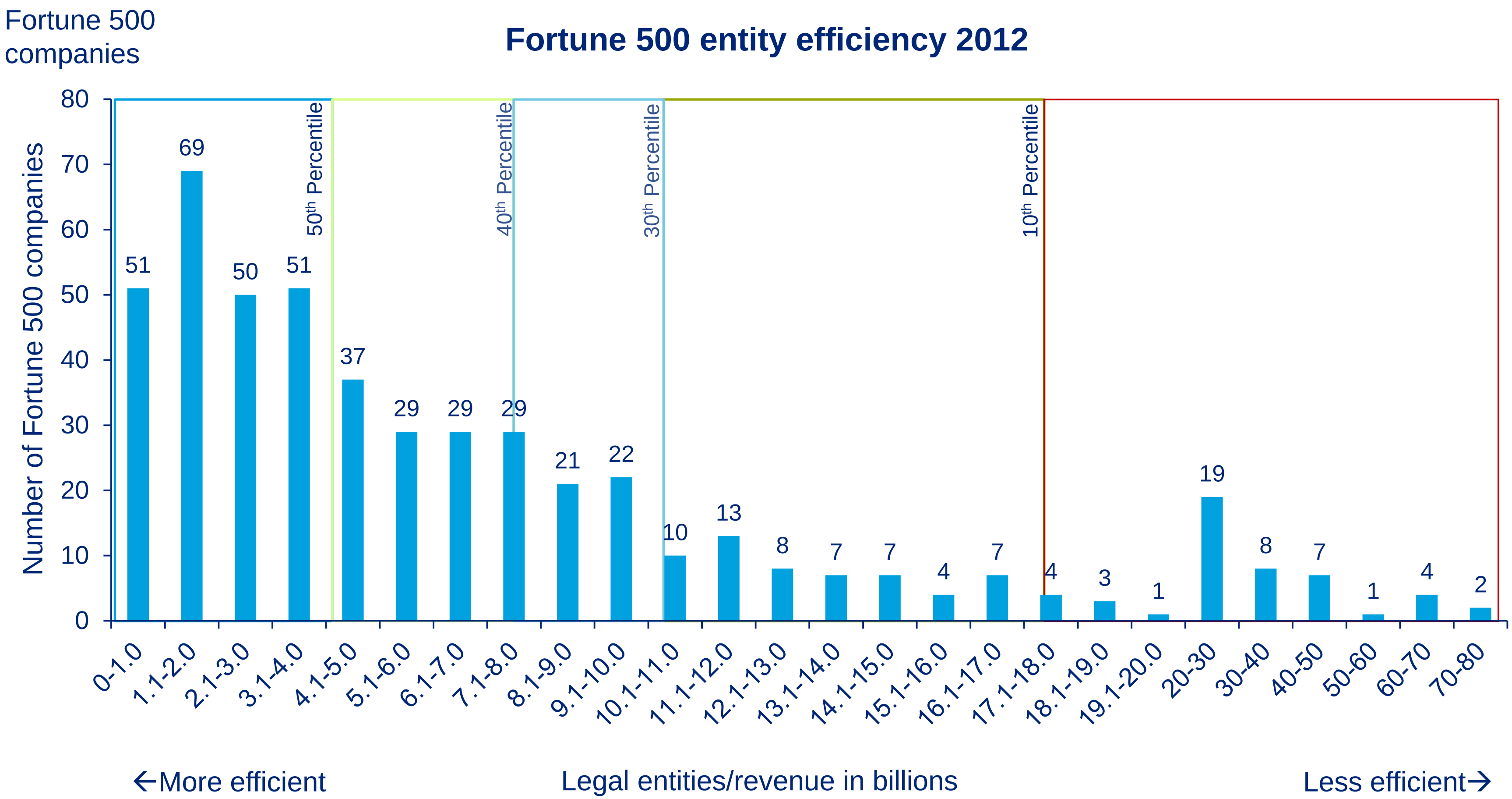
Global Implications and Opportunities

Potential multi-state tax opportunities and pitfalls

Who could benefit from legal entity simplification?

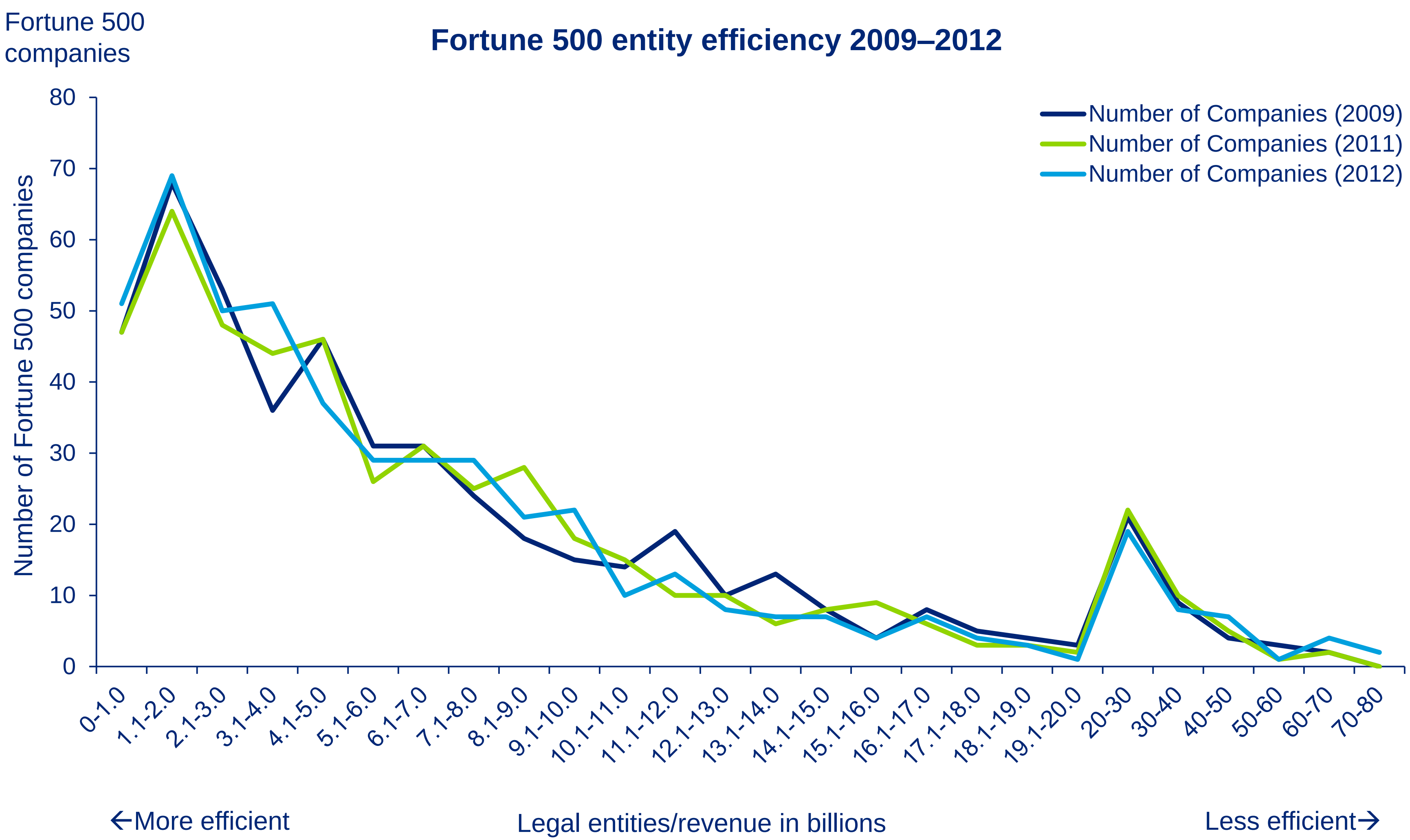
Benchmarking legal entity efficiency

One measure of legal entity efficiency is the ratio of the number of legal entities within the organization for each billion dollars of annual revenue.



Source: 2012 Deloitte Tax analysis of public company data.

Changes over time



Source: 2012 Deloitte Tax analysis of public company data.

Costs and risks of a complex structure

Why is that a problem?

Maintenance of archaic structure creates

- Unnecessary exposure to risk
  - Financial Reporting
  - Tax filings
- Potentially higher tax rates
  - Missed opportunities due to lack of capacity
  - Trapped attributes
  - Liabilities for uncertain tax positions
- Inefficient allocation of resources
  - Inside and outside of the tax department
  - High cost to maintain legal entity structure
- Morale and retention issues
  - Excessive time spent on activities that may not add value
    - Staff and managers do not feel intellectually challenged

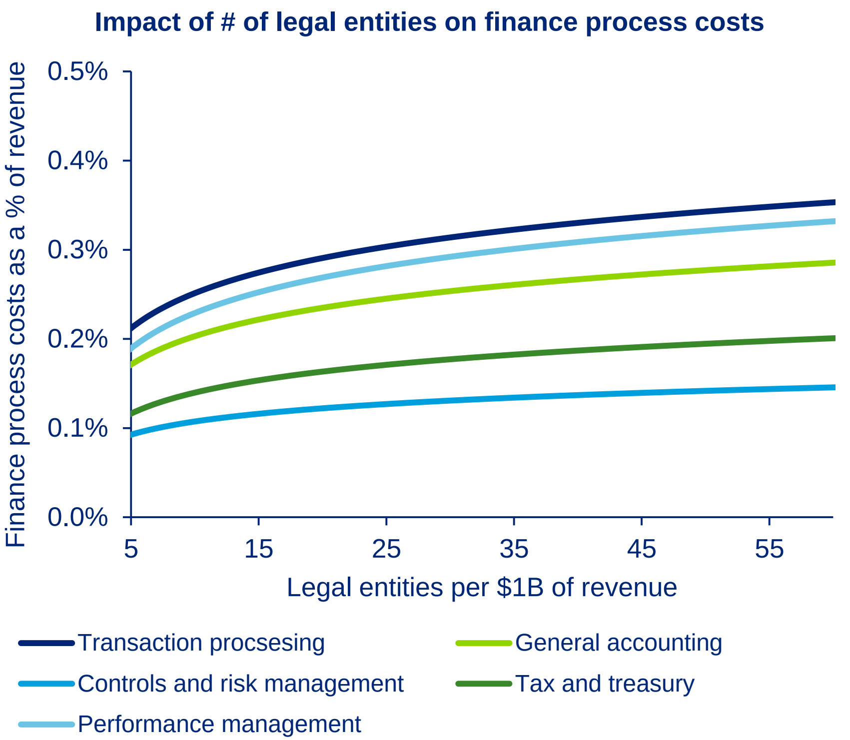
Opportunities for savings

Legal entity complexity impacts process costs across functional areas. A recent study shows the correlation between finance process cost and the number of legal entities.

Study findings and implications[1]

- There is a clear correlation between the number of legal entities and finance process cost
- On average, the difference in finance function cost between enterprises that have 5 and enterprises that have 10 legal entities per billion in revenue is as follows:
  - Performance management: $398K per $1B in revenue
  - Transaction processing: $394K per $1B in revenue
  - General accounting: $319K per $1B in revenue
  - Tax and treasury: $236K per $1B in revenue
  - Control and risk management: $148K per $1B in revenue

Facts and figures[1]



[1]Source: Deloitte Global Benchmarking Center analysis of 400 enterprises conducted in 2011

Entity rationalization may present a potential opportunity to implement other tax planning

- Multiple business reasons may drive need for overall entity rationalization
- Information needed to consider entity rationalization can be used to model global & state tax alternatives
- Global & State income tax savings may potentially help pay for restructuring
- Costs associated with separate entity audited Statutory Financial Statements is a quickly captured savings point
- Multifunction internal resources already primed for corporate restructurings / alignment
- Implementation of new accounting protocols as part of larger transaction

Considerations for a more tax efficient structure

Financial Reporting

- Has your effective state tax rate been increasing or decreasing?
- How does your global effective tax rate compare to competitors?

Uncertain tax positions

- Do you have recurring accruals for unrecognized tax benefits (UTBs)?
  – UTB liabilities for non-reporting may never go away.
- Restructuring may provide opportunity to bring resolution to some financial reporting issues.
- Are NOL’s or credits trapped and unused?
- Is your transfer pricing process & documentation outdated?
- Is your transfer pricing position harmonized across business units and recent acquisitions?

Considerations for a more tax efficient structure Globally

Changes in Operations

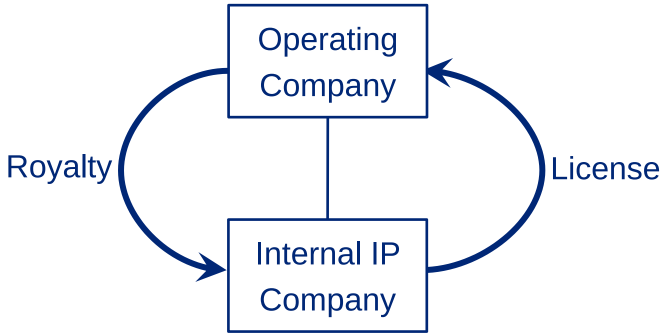
- Have acquisitions or mergers created random, unplanned structures?
- Have acquisitons and carve-outs impacted your Permanent Establishment footprint globally? Or your repatriation expectations?
- Did new or changed operations expand nexus footprint?
  – Does P.L. 86-272 protection continue to apply?
- Have profit centers shifted?
  – Are loss entities being used efficiently?
- Have you considered European or Asian Principal Structures?

Changes in Tax Law

- Impact of Transfer pricing
- W/H tax rates on repatriation planning
- Interest and royalty add-back statutes
- Increased scrutiny by states

Typical structures that may need to be unwound

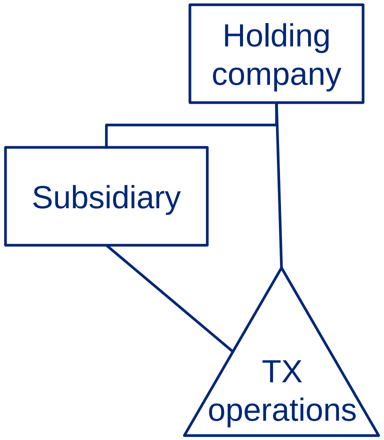
Intellectual property planning



Considerations include:

- "Anti-PIC" is almost universal
  - Royalty add-back provisions
  - Economic nexus ("Geoffrey")
  - Unrecognized tax benefits

Partnership planning



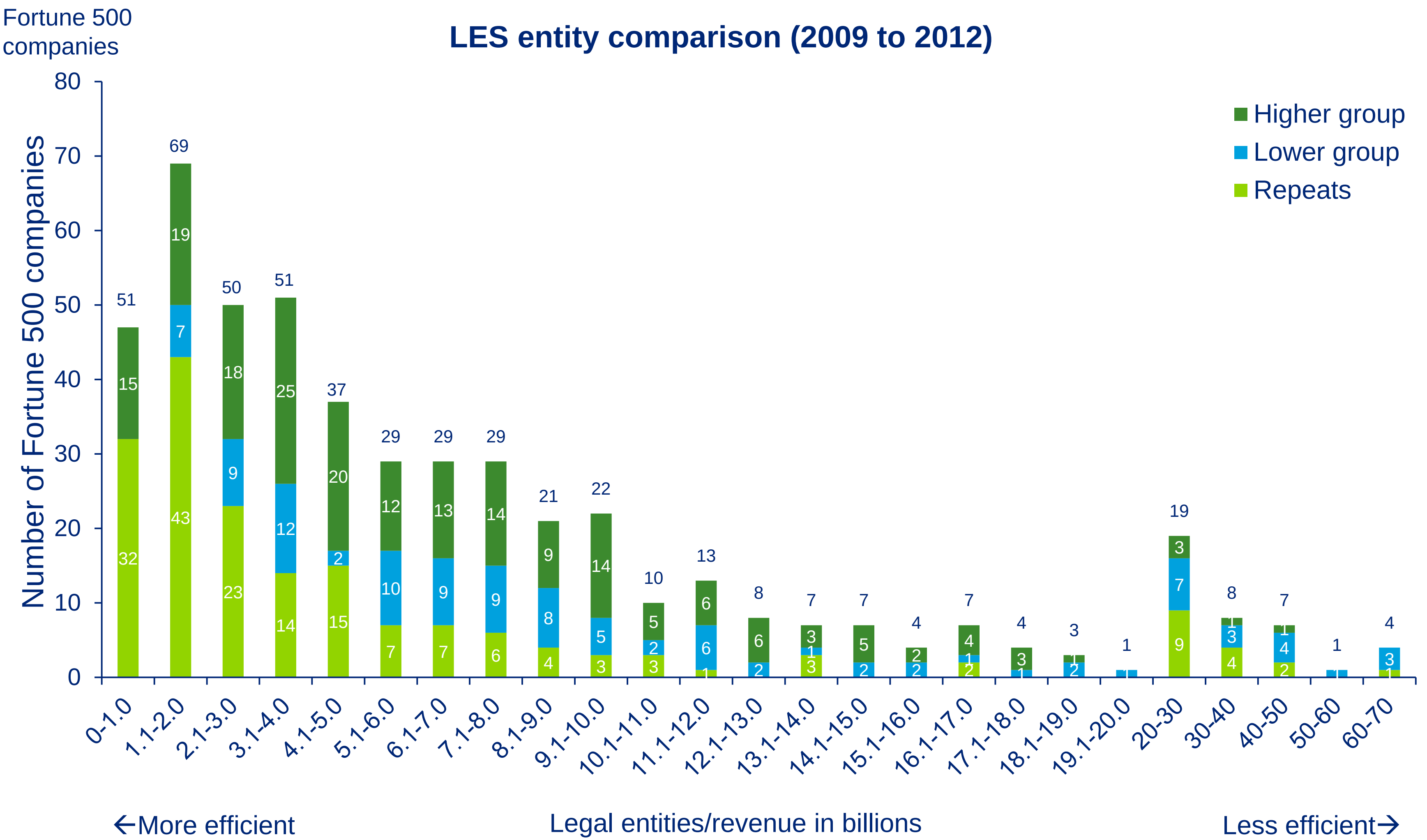
Considerations include:

- Partnership planning benefits may be limited
  - LP is taxable entity under Texas Margins Tax
- Effect of termination
- Partnership vs corporation differences
  - Depreciation

Recommended approach to legal entity simplification

How realistic is your LES goal?

LES entity comparison (2009 to 2012)



Source: 2012 Deloitte Tax analysis of public company data.

Getting organizational buy-in

This can be a substantial undertaking

- CFO sponsorship is necessary
- CEO endorsement may be warranted
- Board communications may be required

May have to overcome competing strategic priorities

- Costs and benefits must be compelling and objectively verifiable

Remember to keep stakeholders involved early and often!

Eight specific bases to be covered

Operating Model

Sample Functional Issues

- Top-down synergy targets
- Customer, market, product/service strategies
- Supply chain and facilities strategies
- Shared services and centers of excellence

Tax & Capital Structure

Sample Functional Issues

- Attribute protection and utilization
- Triggering new taxes
- Tax efficient effective tax rate
- Uninterrupted indirect tax processes

Operations

Sample Functional Issues

- Customer/supplier experience
- Administrative considerations
- Establishing legal presence within a geography
- Legal entity name changes

Finance/Treasury

Sample Functional Issues

- Debt covenants
- Intercompany transactions
- Cash management/repatriation
- Rating agency approvals
- Accounting and SEC reporting (e.g., investments in affected entities)

Legal/Regulatory

Sample Functional Issues

- Comply with state, local and federal laws
- Transfer of assets (e.g., real, personal and intellectual property)
- Public filings/notices
- Business licenses
- Contingent liabilities

Accounting

Sample Functional Issues

- Legal entity books and financial statements
- Statutory audits
- Intercompany transactions
- IFRS implementation readiness

Information Technology

Sample Functional Issues

- Capacity to make changes
- Reporting challenges (timing/granularity)
- Potential changes to data flows (e.g., re-configure ERP system(s)

Human Resources

Sample Functional Issues

- Incentive compensation
- Payroll registration changes
- Employees employers for benefit plans
- Vendor/Payroll/Plan Provision Synchronization
- Organizational change management
- Pay practices
- Employee contracts

Typical LES business case

Objectives	Description
Objective #1: Reduce costs	• Reduce pre-tax recurring costs and regulatory burdens by simplifying the legal entity structure • Streamline intercompany transactions (e.g., transfer pricing and transaction costs) • Create opportunities to reduce costs through process improvement, standardization, and harmonization • Develop policies and procedures to maintain a lean structure
Objective #2: Update tax profile	• Create efficient tax profile (e.g., state and local, international, etc.) • Impact on corporate tax rate and cash tax positions • Consistent tax policy across products and services
Objective #3: Integrate acquired businesses	• Create a legal entity structure which is flexible and facilitates the integration of acquired businesses and more closely aligns with the future state business operating structure • Have "one face" to the customer
Objective #4: Improve risk management	• Improve legal, financial statement and tax data integrity risk management • Streamline, standardize, and harmonize critical business processes to avoid waste of internal resources
Constraints/ Must haves	• Regulatory filing and reporting considerations • Mitigate any impact on operations or the customer experience • Mitigate tax costs associated with the migration from the current structure to any proposed structure • Mitigate compliance issues pertaining to employees change in legal employer • Keep separate credit characteristics for the business lines and navigate existing debt covenants

The "Straw Man Approach"

Common Approaches	Description	Strengths	Weaknesses
Dormant Entities Lead	Focuses on inactive entities first in order to quickly eliminate a large number of legal entities	• Fast process • Measurable progress • Psychologically satisfying • Low risk	• Does not address underlying issues of cost and risk behind the restructuring • Minimal cost savings realized • Does not align legal entity structure with the business
Outside-In or "Jigsaw"	Eliminating or combining entities on a "one-off" basis by focusing on individual merits	• Generates incremental cost savings • Addresses underlying issues of cost and risk	• Slow and subject to delays and elevated risks of stalling out • Scope of reconstruction is limited due to one at a time approach • Trial and error approach • Does not align legal entity structure with the business
Recommended Approach	**Description**	**Strengths**	**Weaknesses**
"Straw Man"	• First, whiteboard a legal entity structure that aligns with business in a tax efficient manner, ignoring existing structure • Then develop a roadmap from existing structure to "straw man," making any required adjustments	• Larger entity reduction than other methods • Quicker buy-in from constituencies • Meaningful cross-functional costs savings and risk mitigation • Better alignment of legal entity structure to business strategy and operating model	• Requires commitment and cannot be done piecemeal, although can be implemented in a multi-wave approach • Initial costs of restructuring likely higher than other two approaches

The Wave approach for implementation

The challenge of the Big Bang approach is that the project can stall, while the Wave Approach:

Achieve wins early in process to establish momentum and encourage stakeholder buy-in

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Identify potential obstacles likely to be encountered later in more complex transactions

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Develop consistent processes in early phases that may be expanded for subsequent transactions

Steps to success

- Addressing Desired Outcomes
- Timely Decision Making
- “Personal Agendas” Undermine Credibility
- Too Many Choices

Global Implications and Opportunities

Agenda

- Avoiding traps for the unwary
- Triggering Losses
  - Liquidations and using disregarded entities
- Indirect Taxes
  - Protecting your supply chain
  - Potential benefits from efficiencies

Entity Rationalization –Traps for the Unwary

- Liquidation of Legal entities can result in:
  - All E&P inclusion under Section 367
  - Triggering Section 311 BIG
  - Triggering Foreign Gains
  - Loss of Tax Basis
  - Triggering Loss Importation Rules under Section 334 and Section 362(e)
  - Springing Debt—May Create Subpart F
  - Loss of Incentives, Holidays and Credits
  - Transfer Pricing Issues---Beware of Principal Company Structures
  - PE Issues
  - Loss of treaty benefits –withholding tax and capital gain provisions.

Triggering Built In Losses

Many taxpayers may have a variety of unrealized tax assets, such as unrealized built-in-losses (“BILs”)

- Such unrealized losses may be triggered as the result of certain structural transactions undertaken as part of an overall entity rationalization strategy, a change in the company’s business model, or similar transaction.
- Two examples of common restructuring transactions involve the use of eligible disregarded and regarded entities.

Use of Disregarded Entities

In today's economy, a taxpayer often finds itself with business unit, housed in a corporate legal entity, that has deteriorated to such an extent that it is now worthless, has had significant losses, or predicts continued losses.

- May include both foreign or domestic business units
- Taxpayers may wish to either write-off the business unit or transfer its losses back to the US or into a different legal entity

Use of Disregarded Entities (cont.)

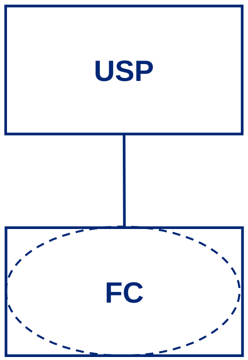
Consider:

- Transferring expected future losses from foreign subsidiaries to the U.S.

- Transferring losses back to another legal entity for state tax planning purposes

- Securing a worthless stock deduction
  - Conversion to a disregarded entity is an “identifiable event” for purposes of IRC § 165(g)(3) (see Rev. Rul. 2003-125)
  - Other criteria under IRC § 165(g)(3) must be met
  - Special rules for consolidated groups

Future Losses and IRC § 165(g)(3) Worthless Stock deductions



FC elects to be treated as a branch

*Reportable transaction disclosure if loss of $10M or more

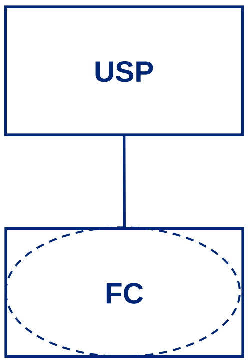
Facts

- FC is a foreign operating company that is insolvent (liabilities in excess of assets)

Requirements to obtain a §165(g)(3) deduction

- Certain stock ownership and gross receipts tests must be met
- The stock that USP owns in FC must have basis
- Security must not have been worthless prior to the year in which worthlessness is being claimed
- The security became worthless in the year claimed
  - *Morton v. Commissioner*, established a two-part test for the finding of worthlessness of stock
  - Stock must cease to have liquidating value
  - There is no “reasonable hope and expectation” that the stock would become valuable at some point in the future
- There must be an identifiable event
  - Rev. Rul. 2003-125 recognizes a check-the-box election as an identifiable event

Future Losses: IRC § 165(g)(3) Worthless Stock deductions



FC elects to be treated as a branch

*Reportable transaction disclosure if loss of $10M or more

Results

- Upon conversion to a disregarded entity, USP takes an ordinary loss deduction provided the following affiliation and gross receipts requirements are met:
  - USP directly owns 80% or more of the voting and non-voting stock of FC; and
  - More than 90% of FC's gross receipts are from active trade or business income

Key Considerations

- Reportable transaction disclosure if loss is $10 million or more
- Need to make sure that FC became worthless in the current year. How to evidence and/or render FC insolvent?
- If worthlessness is contingent on the treatment of related party advance as "debt," then debt-equity analysis required.
- Consider partially funding FC through preferred stock to increase possibility of future worthless stock loss for FC common stock. See *H.K. Porter Co. v. Commissioner.*
- Consider ability for bad debt loss under IRC §166.
- Capital loss if requirements of IRC § 165(g)(3) not satisfied.

Using Regarded Entities – Why Uncheck?

Circumstances from initial entity classification may have changed – examples:

- Loss entity becomes profitable
- Foreign tax credit position has changed and want more control of timing of foreign inclusions

Recent fluctuations in foreign currency exchange rates may create the opportunity to trigger a foreign exchange loss under IRC § 987

Consider: conversion to regarded entity status

Traps for the Unwary

- Application of IRC § 357(c) on incorporation of a branch
- Potential IRC § 367 gains on outbound asset transfers
- Branch Loss recapture
- Dual Consolidated Loss recapture

Other possible traps include, but are not limited to:

- Loss limitation and disallowance provisions
  - IRC §§ 267, 311(b), 362(e), 382, 383, 384
  - Treas. Reg. § 1.1502-36
- Anti-abuse provisions
  - IRC § 269
  - IRC § 482
  - Treas. Reg. § 1.1502-13(h)

Statutory Framework

IRC § 987 provides a framework for taxing flow-through operations:

- Income/loss determined in functional currency
- Functional currency amounts translated into home office currency at average exchange rate
- Currency gain/loss realized on transfers of property from branch to home office or to another branch

IRC § 987 – Foreign Currency

Under the 1991 and 2006 proposed regulations, foreign currency gain or loss under IRC § 987 is recognized only when a qualified business unit (“QBU”) with a functional currency different other than the USD terminates or a remittance is made

QBU Definitions and Principles

- A QBU is a separate and clearly identified unit of trade or business of a taxpayer which maintains separate books and records
- A QBU is presumed to keep books and records in the currency of the economic environment in which a significant part of its activities are conducted

IRC § 987 – Foreign Currency (cont.)

Termination- A termination of a IRC § 987 QBU branch is treated as a remittance of all the gross assets of the branch to its owner

Examples:

- – Cessation of branch activities
- – Transfer to taxpayer of substantially all branch assets
- – Disposition of substantially all branch assets (including deemed sale under IRC § 338)
- – Certain IRC § 351 transactions
- – Certain reorganizations and liquidations
- – IRC § 1248 sales
- – Certain changes in functional currency

- Cumulative unrecognized IRC § 987 gain or loss is recognized on termination of the branch
- Computation of gain/loss will likely differ based on whether 1991 Regulations, 2006 Regulations, or a another method has been adopted.

IRC § 987 – Foreign Currency

IRC § 987 gain or loss is:

- Determined as of the date of termination
- Ordinary income or loss
- Generally foreign source
- Measured by the difference between:
  - The amount of a remittance translated into taxpayer's functional currency at the spot rate on the date remitted, and
  - The Taxpayer's functional currency basis in the remittance

Tax Implications & Considerations

Considerations

When considering alternatives to recognize BILs in assets or utilize capital losses, tax implications to consider include, but are not limited to:

- Proper determination of the application of any loss limitation/disallowance and anti-abuse provisions
- Proper determination of amount and character of gain or loss (capital vs. ordinary) and the impact to the taxpayer

Considerations (cont.)

- Transactions involving foreign entities:
  - Limitations under the dual consolidated loss provisions may apply when structuring with foreign entities
  - Consider the potential for an Overall Foreign Loss (OFL) under IRC § 904(f) and the impact on the client's FTC position.
  - Consider the potential that loss importation rules may apply if the insolvency test is failed.
- **For any potential transaction where a loss may be recognized, careful consideration must be given to the following:**
  - Application of various statutory and regulatory loss disallowance, limitation and deferral rules
  - Potential application of various anti-abuse rules
  - Potential application of certain judicial doctrines which may recharacterize a transaction and/or limit any deductions or losses
  - Examples include, but are not limited to – §§ 267, 269, 362(e) and 382

Considerations (cont.)

- Proper determination of tax basis is crucial when contemplating any transfer or sale, consider qualifying basis computations.
- A worthless stock deduction under IRC § 165(g)(3) may give rise to reportable transaction disclosure obligations for both taxpayers and their advisors (see Treas. Reg. § 1.6011-4(b)(5))
  - For domestic entities included in a consolidated return the worthless stock deduction will require the sale or disposition of the entities assets for an amount less than the outstanding liabilities.

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Indirect Tax Impacts

Avoiding Supply Chain Disruptions and Creating Efficiency from Entity Rationalization

Indirect Taxes, Customs and Trade

Three Main Objectives

1. Preserve your tax and business benefits
2. Avoid impeding or stopping your supply chain
3. Decrease costs and increase compliance by transforming your Indirect Tax and Customs and Trade functions along with the rest of the business

Indirect Taxes, Customs and Trade

Preserve your tax and business benefits

- Avoid incremental duty and irrecoverable VAT
- Maintain duty/VAT savings already in place
- Establish viability of business/tax changes from a VAT, Customs and Trade perspective
- Confirm who can be an importer and/or exporter?

Avoid impeding or stopping your supply chain

- Implement correct registrations; authorizations; permits; invoicing; and reporting for Customs and VAT purposes
- Properly manage cutover issues and the transfer of businesses/inventory at go live
- Draft documents necessary for the cross border movements of goods
- Communicate the changes to vendors, customers and brokers/forwarders

Decrease costs and increase compliance by transforming your Indirect Tax and Customs and Trade functions along with the rest of the business

- Reduce redundancy increase efficiency
- Centralize VAT and Trade functions
- Automate VAT Trade compliance and reporting
- Utilize free trade agreements, bonded facilities and deferment accounts
- Consistent use of IncoTerms

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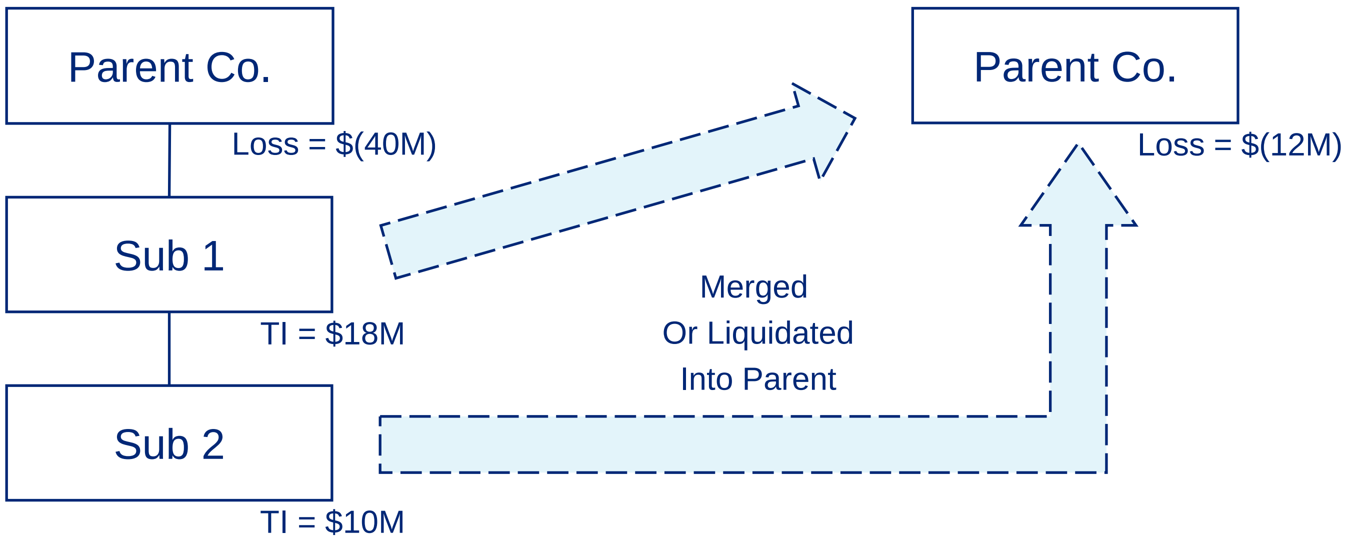
Potential multi-state tax opportunities and pitfalls

State income tax considerations — opportunities and pitfalls

General rules when considering the state tax implications of restructuring:

- State tax considerations must be consistent with strategic and operational business planning.
- Combine income entities with loss entities (if the income entity is filing in separate return states).
- Entities with relatively low taxable income but high apportionment factors are better in separate return states.
- Entities with relatively high taxable income but low apportionment factors are better in combined unitary states.
- Intercompany transactions must be accurately priced and documented, however LES can reduce the need for this.
- Addressing individual state issues may add complexity to structure

Combine profit and loss entities



Common facts

- Subs operate in separate filing states
- Parent Co. incurs interest expense and operates at a loss

Contemplated steps

- Subs are merged or liquidated into Parent Co.

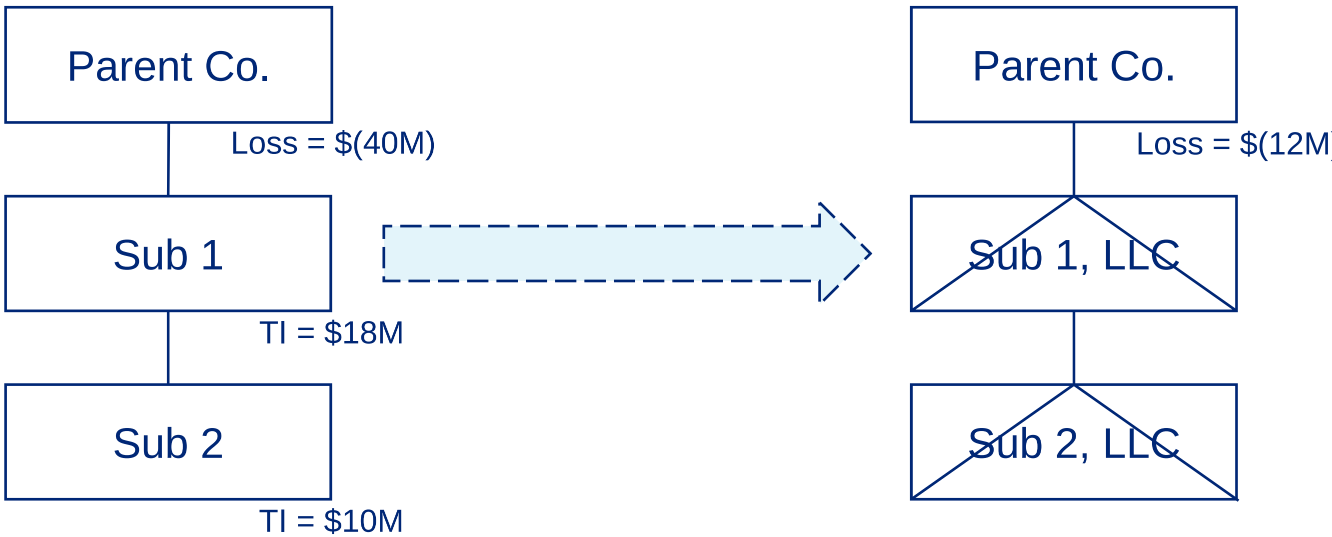
Result

- Parent losses are used to offset income of profitable entities
- Subs operations in separate filing jurisdictions
- Number of legal entities is reduced

Combine profit and loss entities using LLC’s

Use of LLCs Provides Flexibility

Single member LLCs can accomplish effective combination while maintaining separate legal entity.



Contemplated Steps

- Subs convert to LLC(s) treated as disregarded entities for tax reporting purposes

Result

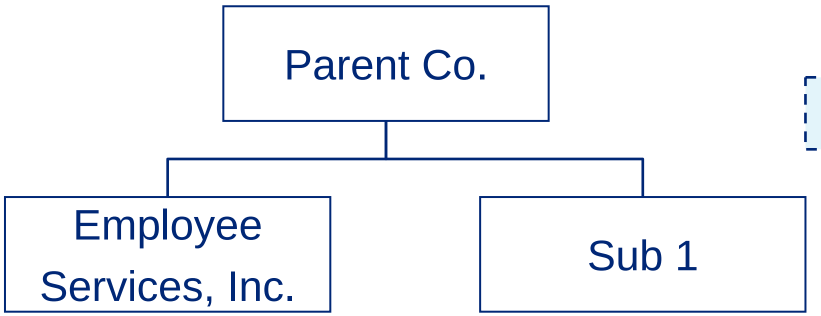
- Parent losses are used to offset income of profitable entities
- Subs operations in separate filing jurisdictions
- Number of *income* tax filings reduced, however other reporting requirements may still exist.

State income tax considerations — opportunities and pitfalls

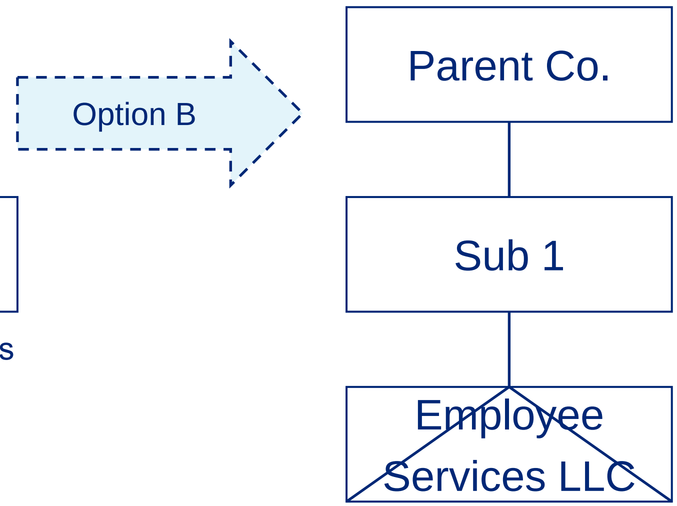
Typical Liquidation and LLC Conversion Considerations:

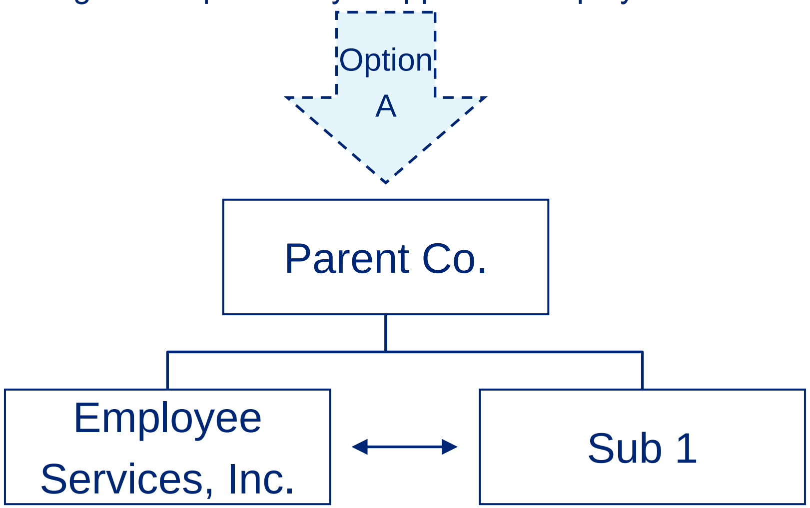
- When an entity formerly treated as a corporation elects to be treated as a disregarded entity for federal tax purposes, it is treated as liquidating all its of its assets into its parent company.
- Assuming all requirements of IRC Sections 332 and 337 are met, no gain or loss is recognized on the liquidation conversion and/or election.
- Any stock or outside basis that the parent holds in the liquidating company is lost upon liquidation.
- FEIN maintenance
- Will SMLLC be a separate sales tax entity?
- Will NOLs survive conversion?
- Be careful of common traps (e.g., deferred intercompany gains with respect to the stock of the converting entity, solvency when taking into account intercompany debt, etc.)

Utilize trapped tax attributes



Hiring credits potentially “trapped” at Employee Services





- Employee Services contributed down to Sub 1
- Employee Services converted to SMLLC
- Employee Services elects to be disregarded
- Hiring credits pass thru to Sub 1

- Sub 1 merges with Employee Services
- Hiring credits utilized in merged entity

State income tax considerations — opportunities and pitfalls

Rationalizing entities may change filing requirements

- Combining entities may cause survivor to file where it was not filing before
- A Company with NOL carryovers may begin paying tax in states where it has no NOLs
- Nexus combined groups may change
- Opportunities and risks of permissive or forced combinations

State income tax planning — opportunities and pitfalls

Other Income Tax Potential Opportunities

- Isolation of specific state operations in a separate entity
- Push down or allocation of company debt
  - Accounting for interest on intercompany balances
  - State interest add-back rules
  - Evaluation of tax consequences of distribution from the subsidiary
- Allocations of corporate overhead
  - Intercompany management agreements
- Isolation of financial/investment assets
  - Thinking ahead about possible divestitures can save state taxes

State income tax considerations — opportunities and pitfalls

States generally follow IRC subchapter C

- Not all states allow NOL carryovers of non surviving entity (NJ)

Most states do not follow the federal consolidated return rules

- Intercompany transactions may not be eliminated — DITs are not forever; they are currently taxed.
- Stock basis may be different without investment adjustments
- §357(c) — liabilities in excess of basis — is not turned off
  - Remember state basis may be different than federal basis
- §304 is not turned off
- §311(b) is not turned off
- Ownership test for §351 cannot be met on a group basis

State income tax considerations — opportunities and pitfalls

Don’t forget potential sales taxes and real property transfer taxes

- Upon transfers of tangible personal property, not all states exempt §368 reorganizations and §351 contributions from sales tax
  - But transfers may fit under occasional sale exemption
- Some state exemptions do not apply to the extent liabilities are assumed
- Liquidations are generally exempt.
- Some state or local real property transfer taxes may be triggered

Question and answer

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