

IP Location Planning (Breakout AA)

33rd Annual TEI-SJSU – High Tech Tax Institute
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Crowne Plaza Cabana
4290 El Camino Real
Palo Alto, CA

Topics and Presenters

- Introduction and Key Considerations
William Skinner, Partner – Fenwick (Moderator)
- Netherlands Structures
Pie Geelen, Head European Desk, New York – DLA Piper
- Irish Structures
Gabe Gartner, Principal – PwC
- Singapore Structures
Jon Davies, Partner – Armanino
- U.S. Structures, including U.S. Branch
Nate Giesselman, Partner – Skadden

Key Considerations in IP Location Planning

- Tax Rate and Incentives in IP Jurisdiction
- BEPS and DEMPE Functions
 - Operations inside and outside IP jurisdiction
- CbC Reporting
- Anti-Avoidance Legislation
 - UK DPT
 - Australia MAAL and DPT
 - Rumblings in France and Germany

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Key Considerations in IP Location Planning

- EU Considerations
 - State Aid
 - ATAD I and II
- US Tax Considerations
 - Temporary § 482 Regulations
 - Current IRS Transfer Pricing Practice
 - Subpart F Planning
 - 2016 US Model Treaty Changes
 - Possible Tax Reform
- GAAP Considerations / ASC 740

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IP STRUCTURING – AN UPDATE ON THE NETHERLANDS

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The Netherlands – a short legislative update

Tax Agenda of newly formed government/coalition (October 2017)

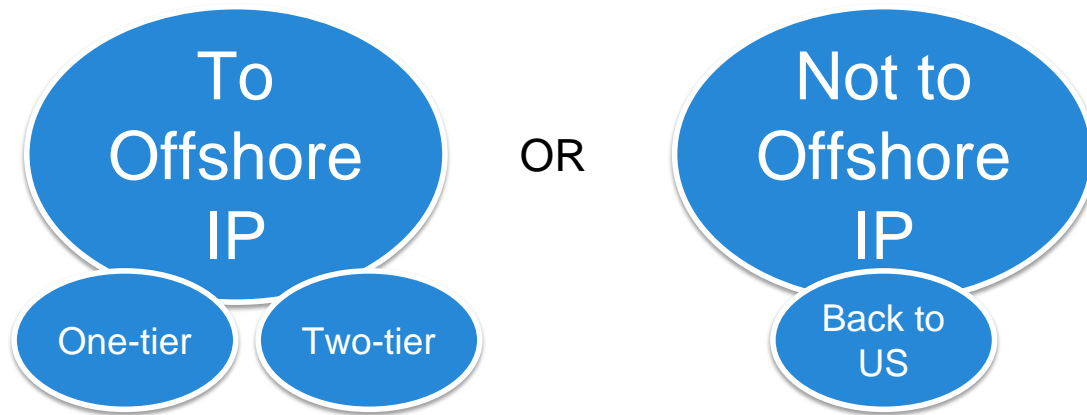
- Reduce tax rate to 21%
- Abolish dividend withholding tax
- Introduction of royalty and interest withholding tax in abusive situations

Other key legislative developments

- Dutch Cooperatives in certain situations subject to Dutch dividend withholding tax
 - Substance requirements for intermediate shareholders of Dutch Cooperatives
- Dutch Innovationbox updated with Nexus approach

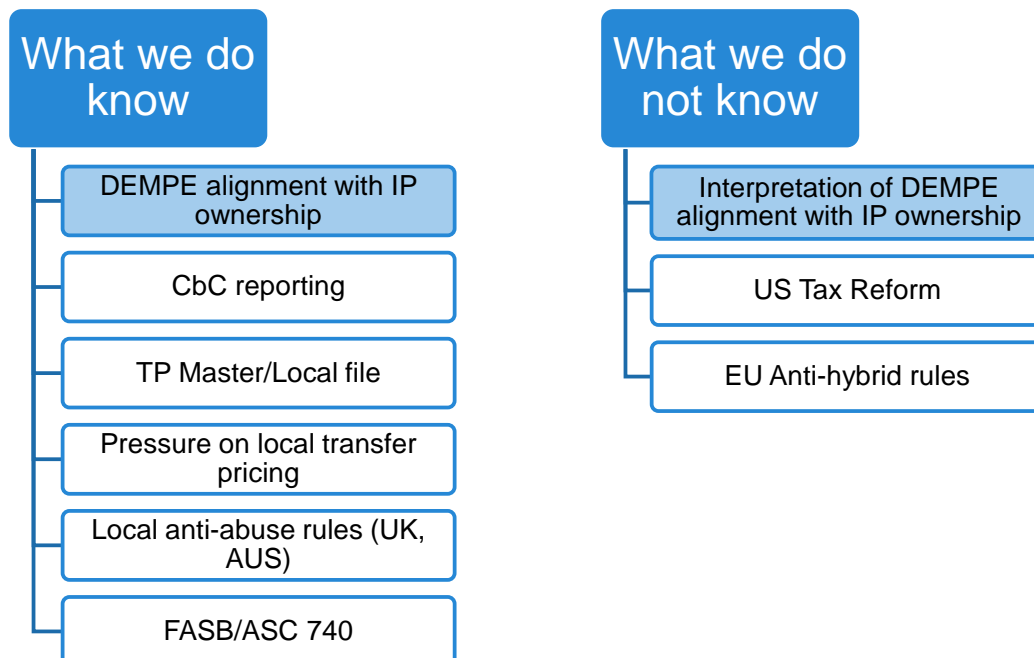
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IP Structuring: The Dilemma



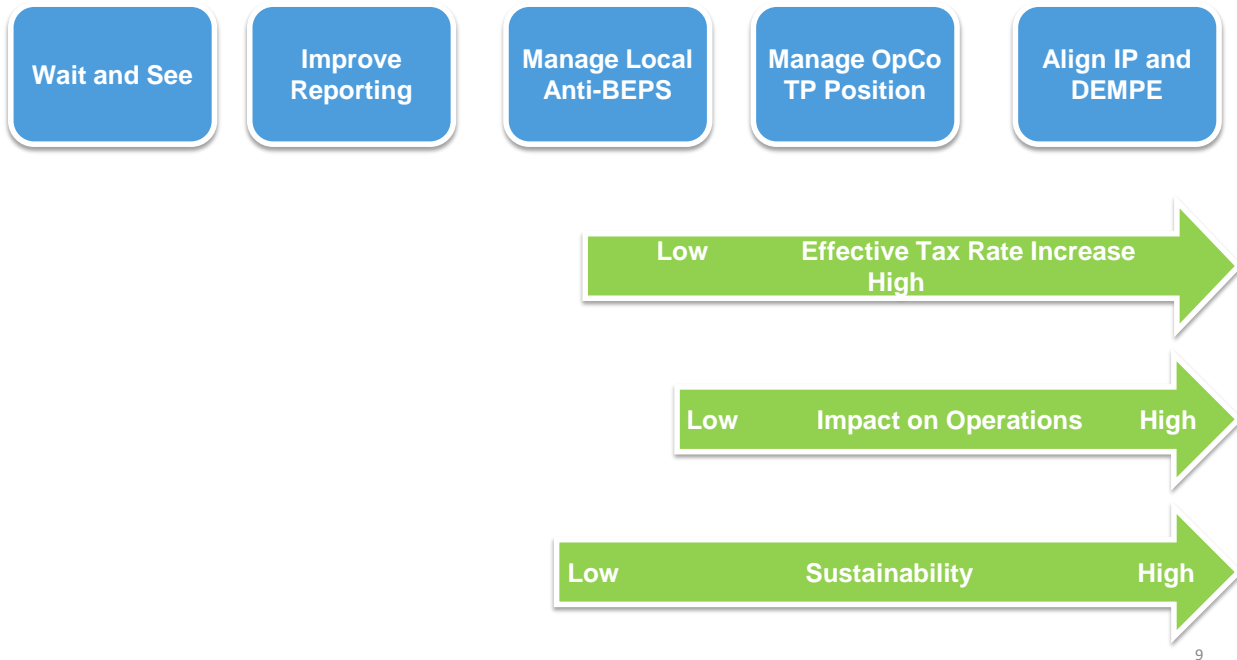
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IP Structuring: Uncertainty in the market place

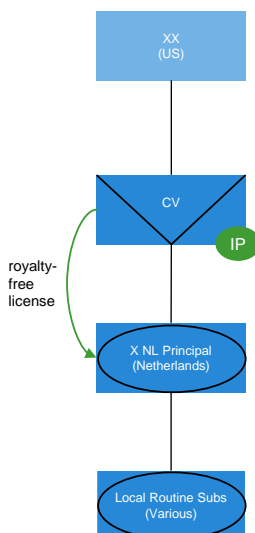


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CV/BV Structures – What are companies doing?



Dutch royalty free license structure: Improve CbC reporting position



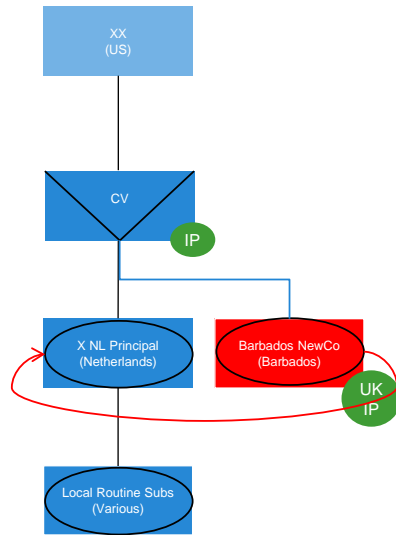
Description

- CV and X NL Principal re-enter into a royalty-free License and Distribution
- For Dutch tax purposes X NL Principal should be entitled to a deemed income tax deduction for tax accounting purposes

Objectives and benefits

- Favorable CbC reporting position as CV does not report royalty income in commercial accounts
- CV funded by dividend income (outside of scope CbC)
- Improves UK imported mismatch anti-hybrid position
- Potentially increases beneficial ownership position of NL Principal by eliminating (back-to-back) payment obligation
- Dutch tax ruling available (but high end of TP range)
- Not invasive to current operating model and does not require change in operational substance

Barbados IP Co: Manage UK Anti-Hybrid rules



Description

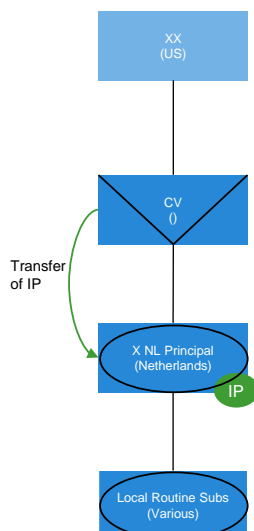
- CV sets up new Barbados company
- CV carves out UK IP to Barbados company
- Barbados company licenses IP to NL Principal

Objectives and considerations

- Primary aim to mitigate UK Anti-Hybrid provisions applicable as of January 1, 2017
- Barbados subject to IBC regime and thus subject to sliding scale of tax in Barbados and therefore allows local UK subsidiary to stay outside of scope of UK anti-hybrid rules

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On-shoring of IP to the Netherlands: Align IP and DEMPE



Description

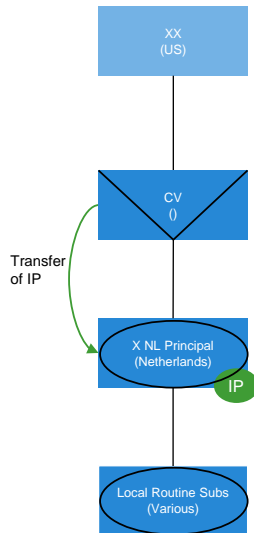
- CV transfers IP to NL Principal in return for a combination of equity and debt
- NL Principal party to CSA going forward
- DEMPE functionality build up in the Netherlands

Dutch Tax

- Step up to FMV of IP in the Netherlands
- IP is amortizable
- Interest expense is deductible
- Credit of withholding taxes available
- Gain upon exit of IP taxable in the Netherlands
- Combination of above elements manages ETR

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On-shoring of IP to the Netherlands: Align IP and DEMPE



Objectives/Benefits

- Creates long term BEPS sustainable tax model
- Eliminates Stateless Entity in structure and CbC report (unless partly financed with debt then interest income in Stateless Entity)
- Allows for DEMPE functionality to be build up in the Netherlands
- Significantly improves beneficial ownership position of NL Principal

Other Considerations

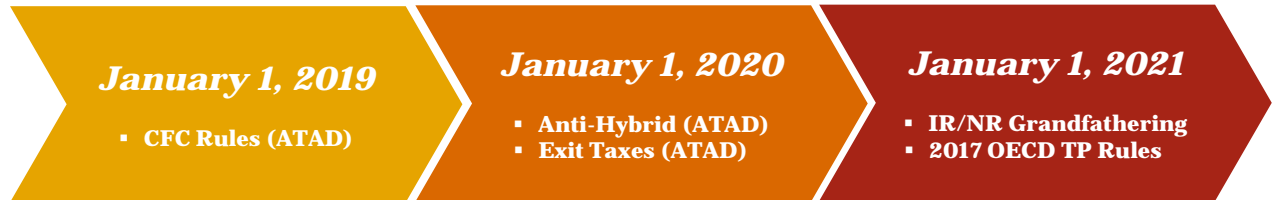
- Dutch tax ruling available
- Financial and tax modelling is key
- Taxable gain recognition of IP upon exit of IP out of Netherlands

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Ireland



Timeline of Expected Changes



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Coffey Report – Key Recommendations

- **Overview**
 - Independent report on Ireland’s corporate tax code released September 12, 2017
 - Prepared by Seamus Coffey (economist from the University College Cork)
 - Includes recommendations for the Irish Department of Finance to consider
- **IP Amortization Regime**
 - Reintroduce 80% “cap” on trading income for a tax year that can be offset by capital allowances from IP (and related interest expense)
- **Transfer Pricing**
 - Update transfer pricing legislation to 2017 OECD Transfer Pricing Guidelines / BEPS Action Items 8-10 by January 1, 2021 (current rules reference 2010 OECD Transfer Pricing Guidelines)
 - Adequately resource Competent Authority
- **International Tax System**
 - Consider adopting a territorial tax system or simplifying foreign tax credit rules
 - Adopt CFC rules under ATAD by January 1, 2019

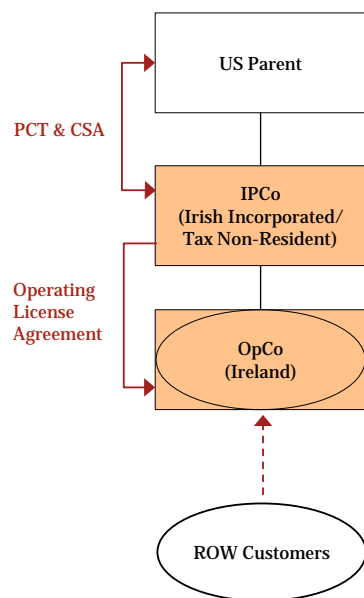
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Update On Ireland's International Tax Strategy

- **Overview**
 - Budget 2018 issued by Irish Department of Finance on October 10, 2017
- **Corporate Tax Rate**
 - Reaffirmed 12.5% corporate income tax rate on trading income
- **IP Amortization Regime**
 - Reintroduce 80% “cap” on trading income for a tax year that can be offset by capital allowances from IP (applicable to IP acquired after October 10, 2017)
- **BEPS and ATAD**
 - Commitment to implementation of OECD BEPS (*e.g.*, Ireland has adopted CbCr, MLI, and Knowledge Development Box with “modified nexus approach”)
 - Commitment to implementation of EU ATAD
 - Does not support moving away from consensus at the OECD level with respect to taxation of Digital Business
- **Coffey Report**
 - Launching consultation process on recommendations in the Coffey Report
 - Consultation period of October 10, 2017 – January 30, 2018

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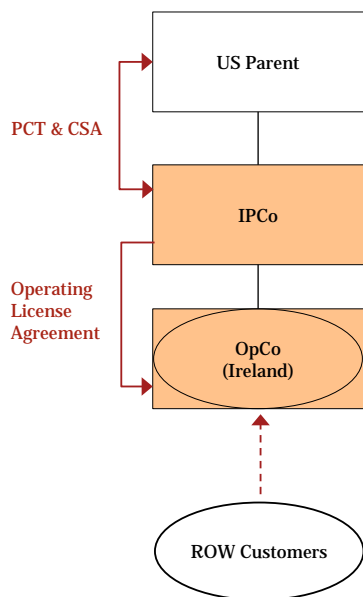
Resident/Non-Resident Structure



- **Changes to Tax Residence Rules**
 - Ireland Finance Act 2014 modified the Irish tax residence rules effective January 1, 2015
 - New companies incorporated in Ireland will be Irish tax resident (subject to “tiebreaker” rules under an applicable Tax Treaty)
 - Existing companies incorporated in Ireland are grandfathered until January 1, 2021 (provided no change in ownership and nature of business)
- **Considerations**
 - 2017 OECD Transfer Pricing Guidelines expected by January 1, 2021 (See Coffey Report, Section 6.3.11)

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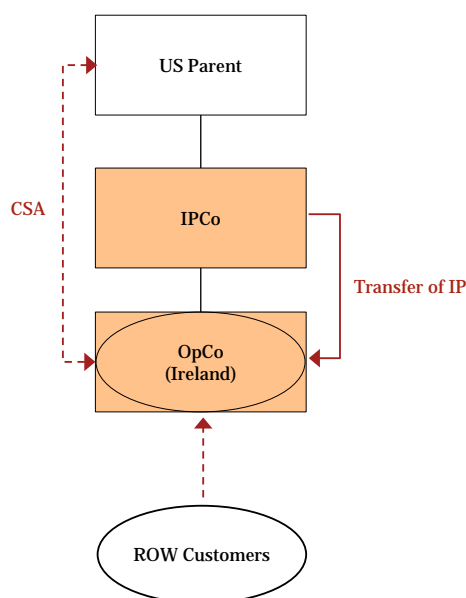
Modified Two-Tier Structure



- **Tax Resident in Tax Treaty Jurisdiction**
 - IPCo is incorporated in Ireland, but tax resident in another country that has a Tax Treaty with Ireland
 - Tax residency under a Tax Treaty generally is determined by the location of management and control
 - For example, Malta generally does not tax “passive income” not remitted to Malta (e.g., royalties paid by OpCo to a bank account of IPCo outside Malta)
- **Incorporated Outside Ireland**
 - IPCo is incorporated and tax resident in a low-tax jurisdiction outside Ireland (e.g., Barbados, Bermuda, or Cayman)
- **Considerations**
 - Anti-hybrid rules under ATAD by January 1, 2020
 - 2017 OECD Transfer Pricing Guidelines expected by January 1, 2021 (See Coffey Report, Section 6.3.11)

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Onshore IP Structure



- **Onshoring of IP**
 - **Entry**
 - IP must be onshored to OpCo in a transaction that is treated as a “capital expenditure” (e.g., a sale or exclusive license)
 - Stamp duty exemption for “specified intangible assets”
 - **Amortization Regime**
 - Section 291A provides for capital allowances with respect to “specified intangible assets” (e.g., patents, know how, computer software, copyrights, trademarks, and goodwill of a business that is attributable to such intangible assets)
 - Customer lists acquired with a business are not amortizable
 - Amortization period is equal to the book life of the IP under Irish GAAP/IFRS (subject to an elective 15-year term)
 - Capital allowances in excess of trading income may be carried forward indefinitely
 - **Exit**
 - Gain on sale of IP by OpCo generally will be subject to Irish capital gains tax at a 33% rate
 - Prior amortization deductions will be subject to recapture if OpCo sells the IP within 5 years
 - OpCo may migrate its tax residence out of Ireland on a tax-free basis if OpCo is 90% owned by a company that is (i) not tax resident in Ireland and (ii) controlled by residents of a tax treaty country
- **Considerations**
 - Reintroduction of 80% “cap” on capital allowances from IP (applicable to IP acquired after October 10, 2017)
 - Exit tax rules under ATAD by January 1, 2020

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Onshore and Knowledge Development Box

Amortization under Section 291A						
Qualifying IP	Transfer Required	Term of Amortization	Cap on Amortization	Carryover of Excess Amortization	Exit of IP Taxed	Claw-back on Exit
Broadly Defined	Capital Expenditure (e.g., Sale or Exclusive License)	Book Life for Irish GAAP/IFRS Elective 15-Year Term	80% "Cap" on Income Offset for a Tax Year	Yes (Indefinitely)	Capital Gains Taxed at 33% if Sell IP	Prior Capital Allowances if Exit Within 5 Years

Knowledge Development Box					
Qualifying IP	Legal Ownership Required	Tax Rate	Qualifying Income	"Embedded Royalties"	Limitations
Patents Copyrighted Software	No	6.25%	Net Income from Qualifying IP	Yes (Where Price for Goods or Services is Attributable to Qualifying IP)	Modified Nexus Approach*

* Modified Nexus Approach: $\frac{\text{Qualifying Expenditures} + \text{Max 30\% Uplift Expenditures}}{\text{Overall Expenditures}} \times \text{Overall IP Income}$

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Singapore Structures

Advantages of Singapore IP Holding Structure

- Large tax treaty network including India, China, Taiwan, major Europeans
- Statutory rate of 17%
- Development & Expansion Incentive- reduced rates of 5 to 15% for qualifying activities (manufacturing, leading-edge activities)
- Productivity and Innovation Credit (PIC) which permits 400% tax deductions is soon expiring
- Intellectual Property Development Incentive proposed with 2017 Budget but was not included in the recent tax bill (was similar to a Patent Box)
- Draft tax bill introduces beneficial rules for foreign companies to re-domicile their IPCo's to Singapore and includes relief from exit taxes imposed by the other jurisdiction
- Writing down allowances (WDA) are granted for capital expenditure incurred in acquiring IP rights including patents, copyrights, trademarks and certain trade secrets that have commercial value
 - Straight-line basis over 5, 10 or 15-year period
 - Presently only applicable through end of Year of Assessment (YA) 2020 (so through end of year ending within 2019)

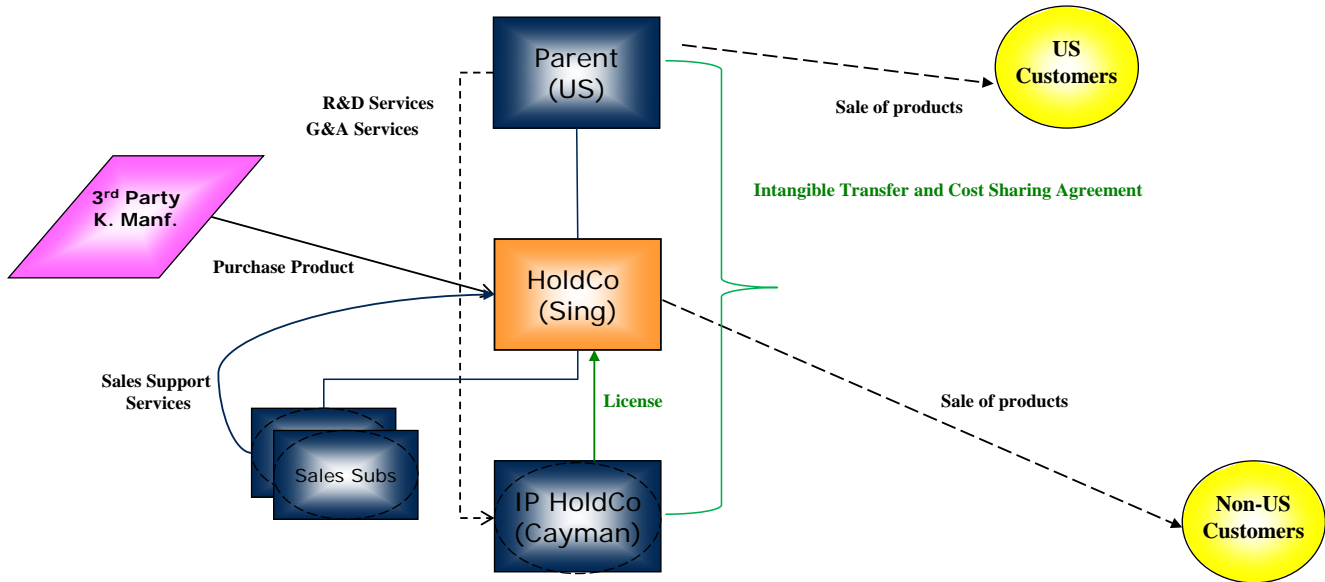
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Advantages of Singapore IP Holding Structure

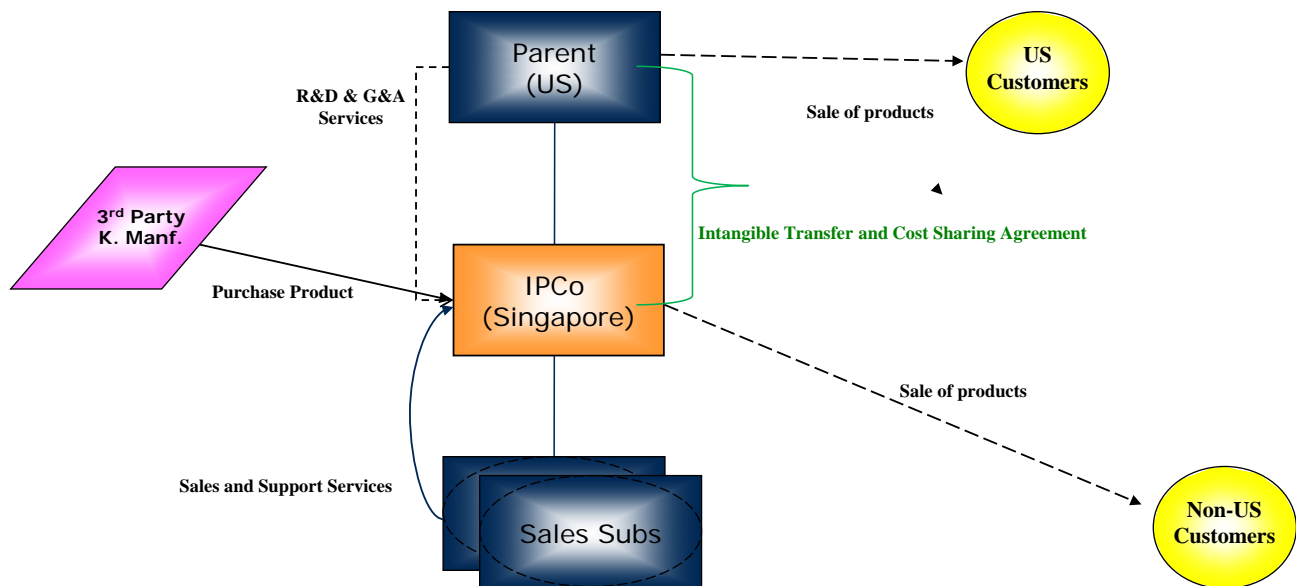
- Cost Sharing Agreements are recognized and deductions generally are permitted for R&D payments made under the CSA
 - Under current rules, the breakdown of expenditures is examined to ensure excluded costs are not expensed
 - New safe harbor has been introduced allowing for 75% deduction for qualifying R&D projects rather than providing the breakdown
- Costs of registering patents, trademarks, designs and certain other IP, including professional fees, can qualify for 100% deduction until last day of YA 2020
- No dividend withholding tax
- The Forum on Harmful Tax Practices (FHTP) released a report on preferential regimes concluding that Singapore's tax incentives satisfy BEPS Action 5
- Instituted CbC reporting for financial years starting on or after 01/01/2017 and signed the Multilateral Competent Authority Agreement for auto exchange of CbC reports
- Volunteered to undergo peer review on implementation of MAP for effective dispute resolution, one of only a few Asian countries to do

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Singapore Structure #1: Transactions



Singapore Structure #2: Transactions



IP Development and Monetization US Perspective

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US Intangibles Rules in the Global Environment

- Despite US involvement in, and stated commitment to, the OECD BEPS initiatives, US rules are increasingly divergent from international standards

- Examples
 - Transfer pricing rules—Section 482 development v. BEPS Actions 8-10
 - Taxation of nonresidents—US ECI rules v. BEPS Action 7
 - Hybrids—US CTB rules v. BEPS Action 2

- This divergence creates both challenges and opportunities, particularly for companies with significant U.S. development activities

- Prospects for US tax reform add further uncertainty

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US Transfer Pricing Developments and BEPS

- US (Section 482)
 - A “corporate finance” approach
 - » Investor model
 - » Income method
 - Clearly delineates asset ownership from activity
 - Upfront “value capture”
 - » 367(d) regulations
 - » “All value” rules in 1.482-1T
 - » Cost sharing regulations and litigated cases
- BEPS 8-10
 - A function-focused approach
 - » DEMPE
 - » Control over risk
 - Commingles asset ownership and activity
 - “Value capture” over time
 - » DEMPE examples
 - » Cost Contribution Arrangement



Differences in transfer pricing analysis create significant double taxation risks and uncertainty in corporate transactions

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Uncertainty from Different Treatment—Example 16

- BEPS Report 8-10 Example 16
 - P conducts R&D, as well as owning S, an R&D provider, and T, a manufacturer
 - P transfers patents to T; “compensation paid by Company T in exchange for the transferred patents and related intangibles is based on a valuation of anticipated future cash flows generated by the transferred intangibles at the time of the transfer”
 - P and S perform contract R&D for T
- US analysis
 - IRS position likely to focus on initial transfer (e.g., PCT payment regulations)
 - After initial transfer, T owns the patents—it is entitled to income it earns and the proceeds of any disposition
 - Change in functions, including creation of T R&D center, no longer relevant
- BEPS analysis
 - T’s acquisition of patents “should accurately be delineated as the provision of financing by Company T equating to the costs of the acquired intangibles and the ongoing development”
 - Consequences unclear—creation of debt instrument, allocation of deductions to P?
 - What if T builds an R&D center in Year 3?
- Given these differences, US transfers that split income and DEMPE functions are particularly challenging

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Treatment of Nonresidents

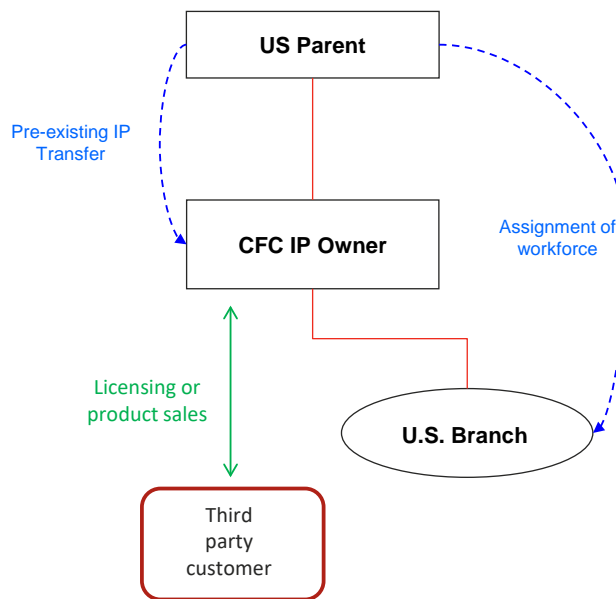
- US (ECI and Subpart F)
 - US rules attribute IP-related income (e.g., royalties) to an office or fixed place of business where the office is a material factor:
 - » “Soliciting, negotiating, or performing other activities required to arrange the license” is a material factor
 - » No material factor where office “develops, creates, produces, or acquires and adds substantial value to, the property”
 - » *Grecian Magnesite*
 - Subpart F active royalty rules require “adding substantial value” and earning third party royalties
- OECD standards
 - Reduced emphasis on contract formation activities
 - Attribution of IP ownership based on DEMPE, functions suggests that R&D activities should attract substantial value



US rules unlikely to treat activities that are critical to OECD/DEMPE analysis as generating ECI, even if they also support Subpart F position

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Combining these Differences—US Branches



Intended Treatment

- US branch activities satisfy DEMPE requirements, so CFC treated as IP owner
- No U.S. ECI
- U.S. activities included in Subpart F analysis

Potential applications

- Third party licensing (active royalties)
- Modified nexus approach

Key considerations

- Branch v. DRE
- 367(d) on setup
- Potential for regulatory change

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Impact of U.S. Tax Reform

- TBD...