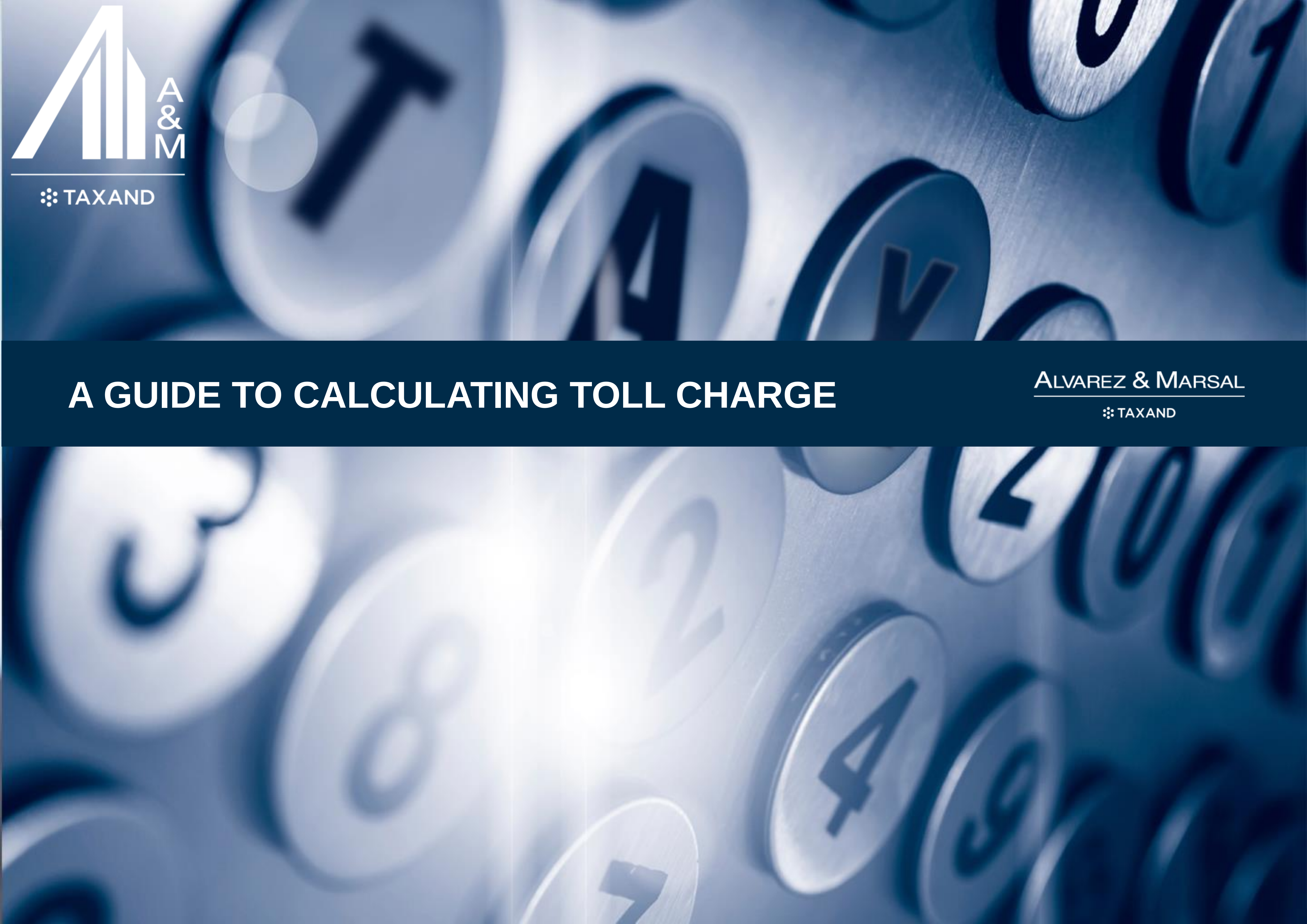

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A GUIDE TO CALCULATING TOLL CHARGE

ALVAREZ & MARSAL

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Tax Reform

The likelihood of comprehensive tax reform has never been greater. The House and Senate have each passed their own version of the bill and are currently aiming to have a reconciled bill to the President before year-end.

While we can expect minor changes in the final bill, one provision is guaranteed: a one-time tax on offshore earnings & profits (“E&P”) of U.S. multinationals. The Senate bill sets the rates at **14.5%** on E&P held in the form of liquid assets and **7.5%** on non-liquid.

Companies can no longer wait-and-see: the toll-charge tax is coming, and reform’s timing will cause a strain on resources to gather information and prepare the calculations for provisions. Now is the time is identify practical and feasible ways to calculate the toll-charge.

Contents

Toll-Charge Workplan

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Identifying Foreign E&P

Key considerations for preparation of detailed calculations on E&P:

- Identifying what information is needed,
- Who has custody of that information, and
- How to be practical about aggregating it.

A high-level process includes the following steps:

- Calculating general versus passive earnings baskets;
- Evaluating foreign currency transaction implications for E&P;
- Determining whether previously taxed income (“PTI”) E&P pools might exist;
- Calculating potential F/X gain or loss on distributions of PTI; and
- Ensuring that E&P reflects arm’s-length transfer pricing on intercompany transactions;
- Reviewing the impact of any historical purchase accounting on E&P balances

A potential time-crunch to prepare these calculations means identifying solutions to expedite the process, such as using balance sheets as proxies for E&P.

Identifying Foreign Tax Pools

The challenges for calculating foreign tax pools include:

- Identifying years worth of foreign tax returns and payments history;
- Locating or translating information.

Some important first steps are:

- Substantiation of payments;
- Identification of creditable foreign taxes (i.e., income-based taxes);
- Foreign tax redeterminations for subsequent foreign assessments or refunds;
- Identification of taxes associated with separate earnings baskets; and
- Application of anti-splitter rules, section 956 anti-hopscotch rule, and other limitations on creditability of foreign taxes

Building a full tax pool calculation in a short period of time may be impossible, especially if the work has never been started or done before. Companies should be identifying and prioritizing which of their foreign entities will have the most material tax pools and which can rely on a high-level estimate.

Calculating the Toll-Charge

Key considerations for toll-charge calculation, once the E&P pools and tax pools are gathered:

- What is the makeup of E&P between liquid and non-liquid assets?
- What is the foreign tax credit limitation? Is there an overall domestic loss (“ODL”) that can be used?
- What is the impact on any existing deferred tax liabilities on offshore earnings?
- When is this tax due? With additional visibility into foreign E&P, does repatriation of some offshore cash to help pay the tax make sense?

Toll-Charge Takeaways

This toll-charge is NOT a routine E&P and FTC calculation. There are many important provisions making this more complicated than traditional computations:

- Operates as a deemed dividend of offshore earnings & profits; however, calculating the amount of that deemed dividend requires several steps. Primarily dependent on three new calculations:
  - (1) Aggregate E&P → Determination of Aggregate Foreign E&P and Aggregate Foreign E&P Deficit
  - (2) Cash and equivalents → Determination of Foreign Cash Position under new rules. Note that in groups with intercompany transactions may experience double counting of assets under the cash position rules. Taxpayer may ask Service for permission to correct double counting. Cash position equals the greater of the current cash position or the average of the cash position as of November 9 with the preceding year. Service may disregard “abusive” transactions if principal purpose is to reduce the cash position.
  - (3) Deductions allowed at the shareholder level → Based on taxpayer’s foreign cash position.
- Foreign Tax Credit offset(s) are also available against the tax on the toll-charge inclusion, but are subject to traditional Sec. 904 limitations; traps like OFLs could limit FTC benefit.
- Although the full tax is not due all at once, many taxpayers will need to prepare calculation and make payments within the next few months.
- Taxpayers with historical ownership of CFCs and/or 902 corporations whose ownership has fluctuated will need to apply year by year ownership percentages to the underlying earnings to determine the amount of applicable E&P and FTCs.

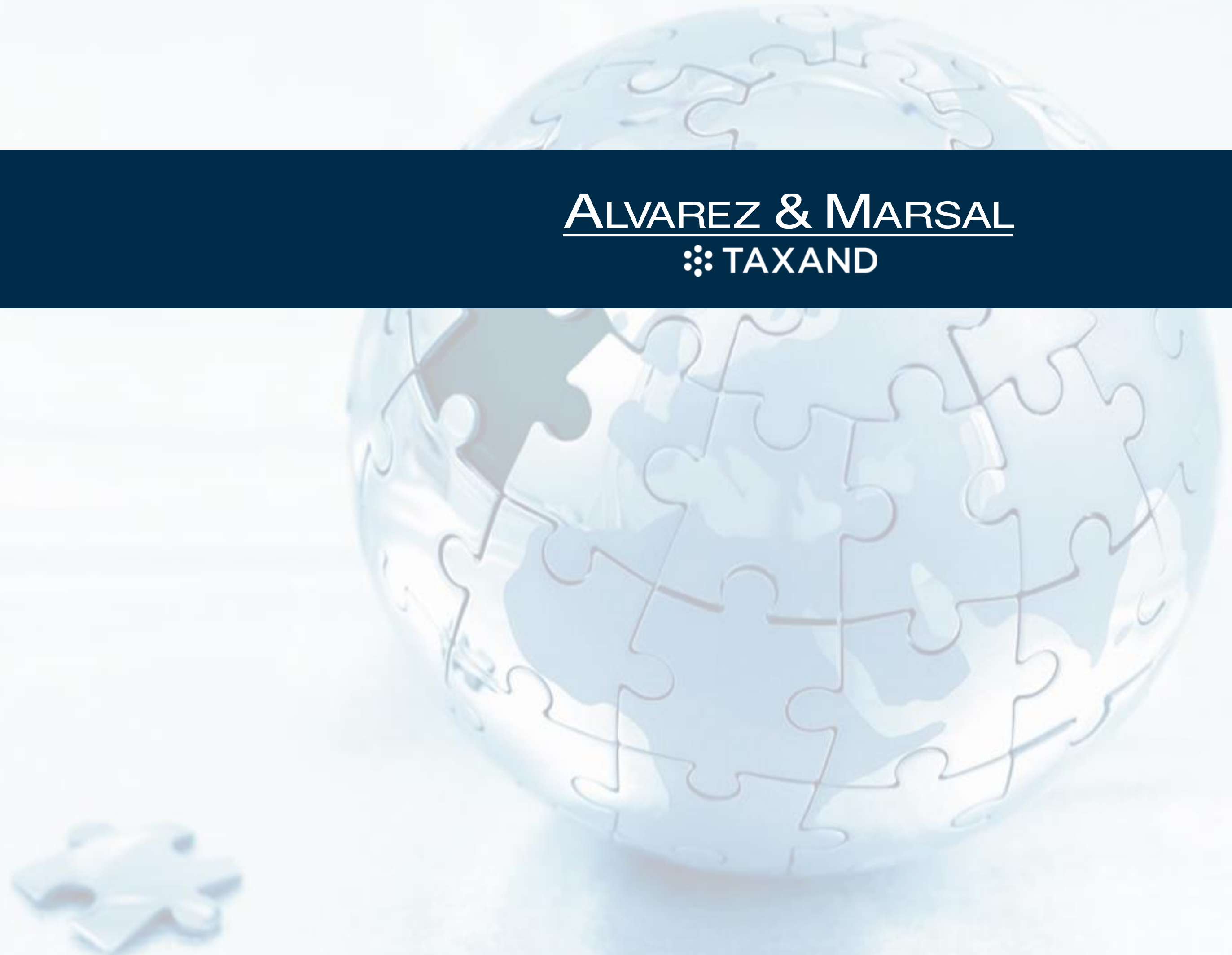
Information Gathering

Typical Information Request

Pertinent information to identify and start gathering:

- ❑ Historical tax returns and Form 1118s
- ❑ Organizational charts
- ❑ Dividends, both historical and deemed
- ❑ Expense allocation support
- ❑ FTC credit carryforward support
- ❑ NOL support
- ❑ Historical 382 studies
- ❑ Information from relevant Controlled Foreign Corporations (“CFCs”):
  - Tax payment substantiation
  - Historical trial balances
  - Local tax returns
  - Historical Forms 5471
  - History of any dissolutions, liquidations, or mergers the CFC was a party to
  - History of any 338 elections made by or with respect to the CFC
  - History of any 367(d) contributions made to the CFC

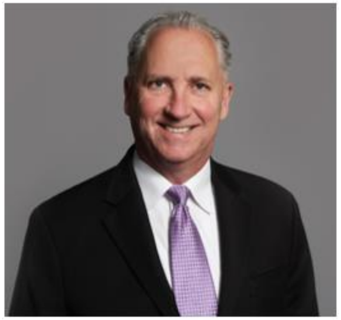
Key Contacts



A&M Tax Reform Specialists

ALBERT LIGUORI
New York
aliguori@alvarezandmarsal.com
+1 212 763 1638

ADAM BENSON
New York
abenson@alvarezandmarsal.com
+1 212 763 9586



BRIAN CUMBERLAND
Dallas
bcumberland@alvarezandmarsal.com
+1 214 438 1013

JILL HARDING
San Francisco
jmharding@alvarezandmarsal.com
+1 415 490 2279

DREW JOHNSON
Washington, D.C.
ajohnson@alvarezandmarsal.com
+1 202 688 4289

DOUG SAYUK
San Jose
dsayuk@alvarezandmarsal.com
+1 408 293 3180

Disclaimer

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