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Trends and Transactions in the Marketplace

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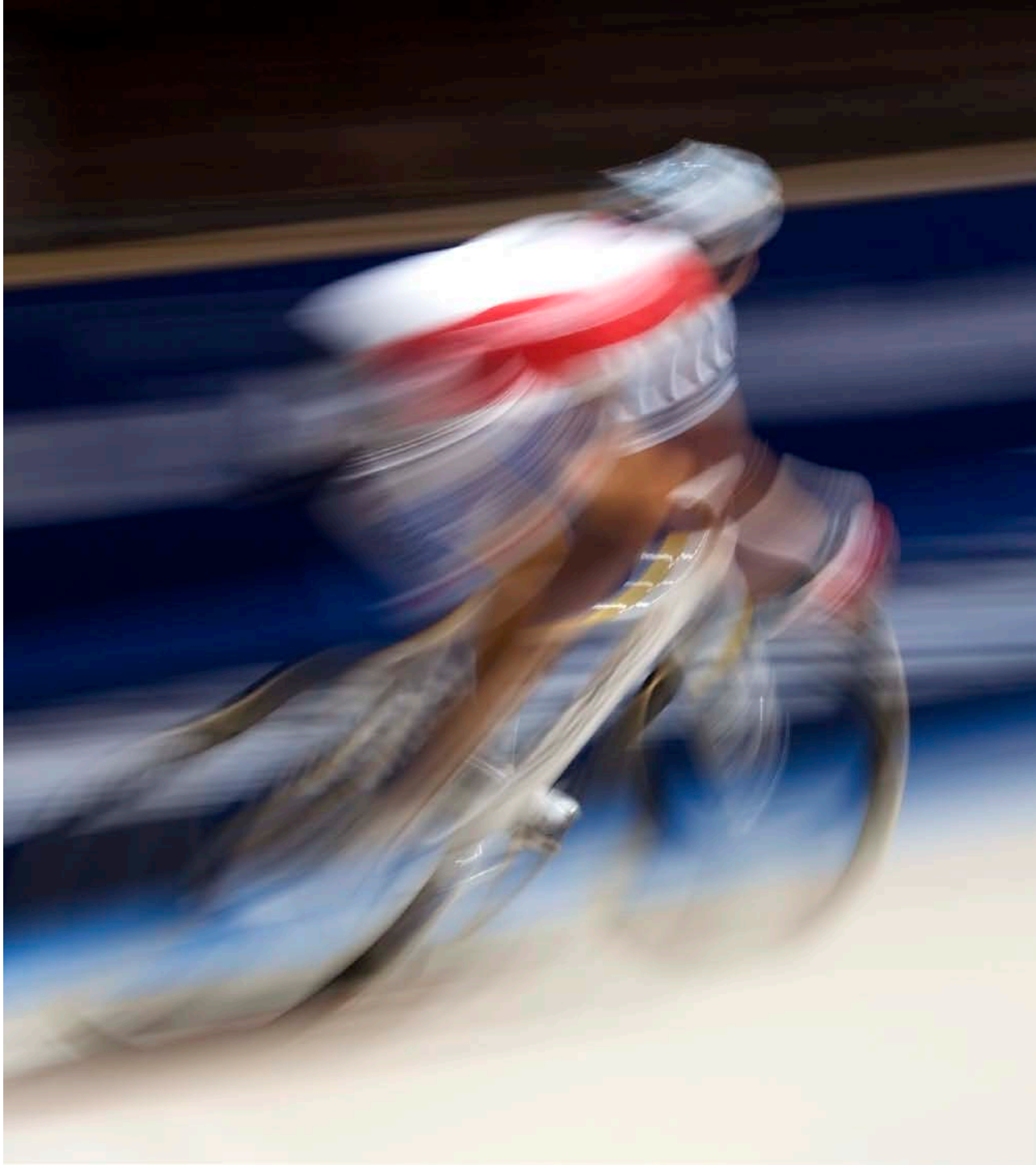


Agenda

Discuss current transactions and trends in the M&A marketplace that are designed to increase shareholder value through the reduction of global tax and/or the increased repatriation of operating cash flows to shareholders.

Topics

- Recent trends in cross-border M&A after the treasury notice on inversions
- Monetization of real estate through the use of REITs
- Use of master limited partnerships as a source of capital

Recent trends in cross-border M&A after treasury notice on inversions

Potential transactions to expatriate and impact on shareholder continuity

Potential transactions to expatriate

Method	Criteria
1. Substantial business presence	• U.S. corporation migrates to a jurisdiction in which the expanded affiliated group has “substantial business activities” (or “SBA”) • SBA requires at least 25% of the group’s sales to unrelated parties, employees, and tangible assets be located in the foreign country where new foreign parent is organized
2. Business combination with a foreign target	• A U.S. and a foreign corporation combine under a new foreign parent corporation • Less than 80% of current shareholders of U.S. corporation own new foreign parent corporation afterwards
3. Go private	• Existing shareholders of U.S. corporation sell more than 95% of their shares to a private equity fund or strategic buyer • As a 95%+ sell-down is required, this alternative might require a cash-out of executive stock-based compensation

U.S. tax issues at shareholder continuity levels

U.S. company shareholder continuity	General rules
80% or greater continuity	• Taxable to U.S. shareholders of the U.S. corporation (if New Parent is treated as a foreign corporation) • 15% excise tax on stock-based compensation related items may apply to officers and directors • Foreign acquirer domesticated unless the SBA exception applies • Category applies if the shareholders of the U.S. corporation receive at least 80% of equity in foreign acquirer
79% to 60% continuity	• Taxable to U.S. shareholders of the U.S. corporation • 15% excise tax on stock-based compensation related items may apply to officers and directors • Foreign acquirer not domesticated, but “inversion gain” taxable to the U.S. corporation (with no use of tax attributes available against inversion gains), unless the SBA exception applies • Category applies if the shareholders of the U.S. corporation receive less than 80%, but at least 60%, of equity in foreign acquirer • Notice 2014-52 announces retroactive regulations that significantly limit ability to re-deploy offshore cash and business assets out from under the U.S. group
59% to greater than 50% continuity	• Taxable to U.S. shareholders of the U.S. corporation • Foreign acquirer not domesticated • Category applies if the shareholders of the U.S. corporation receive less than 60%, but greater than 50%, of equity in foreign acquirer
50% or less continuity	• U.S. shareholders of the U.S. corporation not taxable (assuming GRAs or no 5% ownership) assuming combination with a foreign target with a 36-month active trade or business outside the U.S. • Foreign acquirer not domesticated • Category applies if the shareholders of the U.S. corporation receive 50% or less of equity in foreign acquirer

Notice 2014-52: Announced future anti-inversion regulations

Notice 2014-52:
Overview

- Notice 2014-52 announced the intent of Treasury to issue regulations that would (i) increase the effective tax rate to foreign acquirers of U.S. targets by limiting the opportunities to achieve tax efficiencies in the course of integrating the operations, management and financing of the businesses, and (ii) tighten the anti-inversion rules of Section 7874

- Such regulations would generally apply to transactions completed on or after September 22, 2014

- The Notice further provides that the Treasury and the IRS are considering additional guidance to limit inversion transactions and the benefits thereof and requests comments on earnings-stripping strategies, which are not limited to interest deductions under related party debt instruments

Notice 2014-52:
Overview (cont'd)

- The Notice further indicates that Treasury is reviewing its treaty policy regarding inverted groups and the extent to which taxpayers inappropriately obtain tax treaty benefits that reduce U.S. withholding taxes on U.S. source income.
- The future regulations announced in the Notice will not prevent or otherwise block the ability of U.S.-based entities to expatriate through appropriate business combinations (albeit with higher costs for post-transaction integration) or when the substantial business activities exception of Section 7874 is otherwise available

Notice 2014-52:
Overview (cont'd)

Such regulations would

- Revise the computation of the ownership continuity percentage under Section 7874(a)(2)(B)(ii) in cases where
  - The foreign acquirer has substantial passive assets ("cash box" transactions)
  - The U.S. target has made non-ordinary course distributions within the 36-month period ending on the acquisition date ("skinny down" transactions)
  - The shares of the foreign acquiring corporation are re-transferred in a transaction related to the acquisition of the U.S. target (particularly in the context of "spinversion" transactions)
- Treat an obligation or stock of a foreign related person as "United States property" for purposes of Section 956 to the extent such obligation or stock is acquired by an "expatriated foreign subsidiary" during the ten-year inversion gain period of Section 7874(d)(1)

Notice 2014-52:
Overview

Such regulations would (cont'd)

- Recast certain "specified transactions" pursuant to which a "specified related person" dilutes a U.S. target's share ownership of an "expatriated foreign subsidiary" as an arrangement between the specified related person and the U.S. target to the extent such transactions occur during the ten-year inversion gain period of Section 7874(d)(1) ("de-controlling transactions")
- Revise Section 304(b)(5) to provide that none of the foreign acquirer's earnings and profits will be taken into account unless more than 50% of the Section 304 deemed dividend is (i) sourced out of earnings and profits of that foreign acquirer corporation and (ii) otherwise subject to U.S. tax or included in the earnings and profits of a CFC

Post-notice 2014-52 transactions

Proposal	Description	Practical Effects
Stay under 60% ownership continuity	New Foreign Parent issues solely stock to acquire Foreign Target (FT) and a mix of stock and cash to acquire US Target (UST). Non-pro rata use of cash helps ownership continuity stay below 60%.	If ownership continuity below 60%, then generally Notice 2014-52 does not apply. Use of “boot” to skinny down the FMV of the equity of UST.
Offshore cash and asset purchases	If Notice 2014-52 applies, foreign subs of UST buy assets from FT for cash. Deploy cash on high-growth opportunities.	Purchases shift mature assets into the US tax system and cash out of the US tax system to deploy in high-growth areas.
Partnership freeze	If Notice 2014-52 applies, foreign subs of UST and subs of FT form a US partnership to hold the combined operating assets, with preferred return held by UST’s subs.	Freezes value of UST’s offshore investments and allows for residual growth outside the US tax system.

Legislative proposals

Proposal	Description	Practical Effects
Lower Section 7874 Ownership Continuity (Levin Stop Corporate Inversions Act)	The proposal would reduce the ownership continuity level from at least 80% to more than 50%, and eliminate all threshold triggers if the acquirer's EAG is managed and controlled in the U.S. and has 25% of employees, comp, assets, *or* income in the US. The change would be effective for taxable years ending after May 8, 2014, with no grandfathering.	If the SBA exception was not met, and if enacted, New Parent would become a U.S. corporation if over 50% ownership continuity by former Parent shareholders.
Accelerate income recognition (pay before you go act)	The proposal would require an expatriating U.S. entity to include in income the attributable earnings and profits of its foreign subsidiaries immediately prior to an expatriation.	If the SBA exception was not met, and if enacted, the effective tax rate and cash tax cost of an expatriation would be dramatically increased.
Denial of Treaty Benefits (Rangel/ Doggett Anti-Tax Haven Act)	The proposal would limit the application of a U.S. income tax treaty for the purpose of claiming a reduced rate of U.S. withholding on deductible payments (e.g., interest) made to related parties if the ultimate parent is resident in a non-treaty jurisdiction.	Provided New Parent is entitled to benefits of a U.S. income tax treaty, this proposal should have no negative impact even if enacted.
Tighten interest deduction limits (Camp, Obama, various)	Various proposals to reduce the 50% of adjusted taxable income limit of Section 163(j) for related-party interest deductions to, depending upon the proposal, 40%, 25% or 10% (unless U.S. leverage is no higher than world-wide leverage).	If any proposal is enacted, the tax benefit attributable to the New Parent structure could be reduced.

Monetization of real estate through REITs

REITs – general U.S. Tax principles

In accordance with the regime applicable to a Real Estate Investment Trust (REIT), income derived by a REIT is not subject to U.S. federal income tax, provided that such income is distributed currently to the holders of the equity interests in the REIT

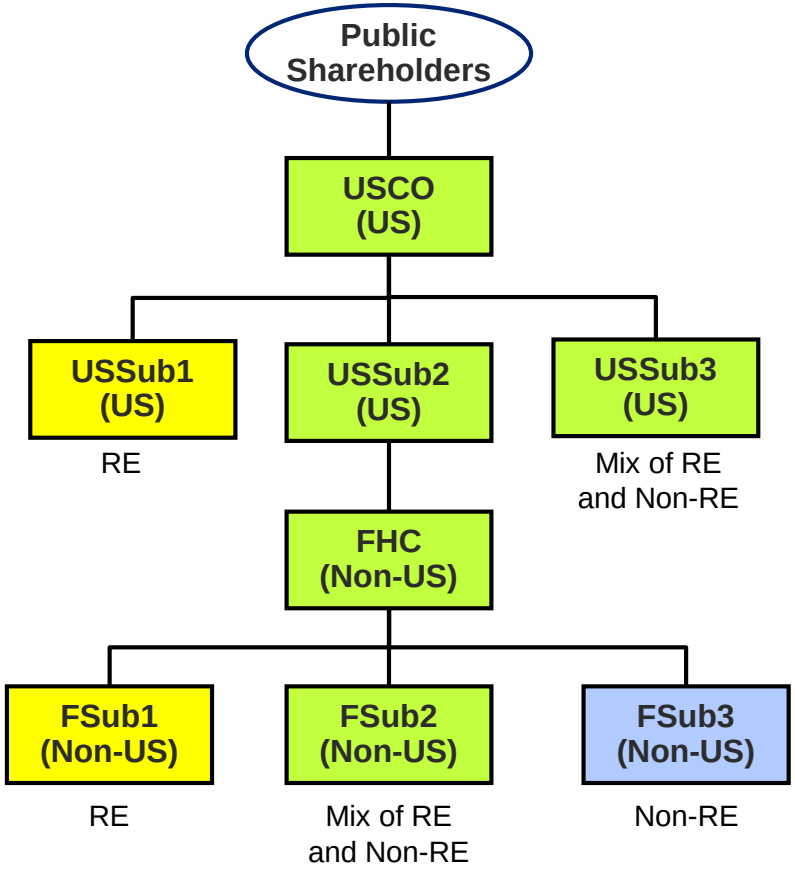
- In general, a REIT is a publicly traded domestic corporation that is managed by a trustee or directors that meets specified income and asset tests as well as a distribution threshold.
- Under the income tests
  - At least 95% of the gross income of the REIT and its qualified REIT subsidiaries (QRSs) consist of dividends, interest and specified real property income
  - At least 75% of the gross income of the REIT and its QSRs consist of specified real property income and interest on obligations secured by real property

REITs – general U.S. Tax principles

In accordance with the regime applicable to a Real Estate Investment Trust (REIT), income derived by a REIT is not subject to U.S. federal income tax, provided that such income is distributed currently to the holders of the equity interests in the REIT (cont'd)

- Under the asset test
  - At least 75% of the value of total assets of the REIT and its QRSs consist of real estate assets, cash and cash items (including receivables) and Government securities
  - Not more than 25 percent of the value of total assets consist of other securities or interests in one or more taxable REIT subsidiaries (TRSs)
- Under the distribution rule, in general, a REIT must distribute for each year the sum of (i) at least 90% of its REIT taxable income, (ii) at least 90% of its net foreclosure income and (iii) 100% of noncash income
- A REIT is subject to U.S. federal tax. However, a REIT is entitled to a deduction for amounts distributed to its shareholders. Thus, a REIT is an entity that potentially has a single level of US federal income tax

Monetization of real estate through REITs

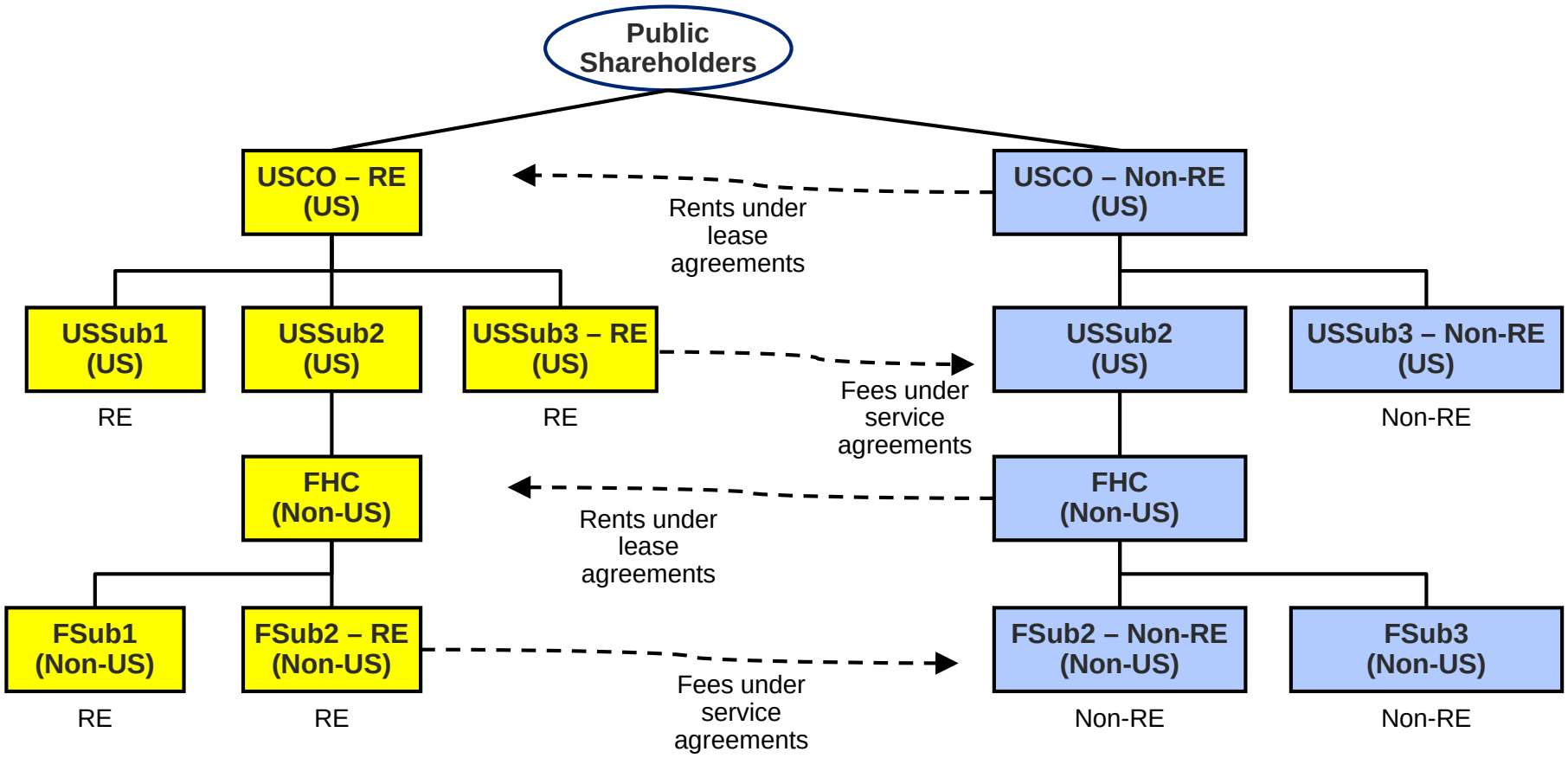


Before Restructuring

Relevant U.S. Tax attributes and activities

- USCO is a publicly traded U.S. corporation
- The USCO group holds real estate as well as conducts business activities involving that real estate
  - For example, the USCO group might hold hotels, stores, storage facilities, pipelines, or power generation equipment and transmission lines
- Members of the USCO group are both U.S. and non-U.S.
- Some members of the USCO group hold only real estate (RE), while other members hold only business operating assets (Non-RE) or hold both RE and non-RE

Monetization of real estate through REITs (cont'd)



After Restructuring

REITs – restructuring issues

In order to meet the income and asset tests for REIT qualification, a U.S. group may often need to split itself between the “REIT” and “non-REIT” activities

- Because real estate assets and income are generally not uniformly housed in separate entities, the separation is generally in the form of one or more reorganizations and Section 355 distributions
  - Section 355 is a complicated provision that requires significant focus on historical information for the group, as well as taking into account possible future transactions involving both the REIT and Non-REIT groups
  - In addition, such split-up transactions can give rise to significant tax issues in the cross-border context to address both Section 367(a) and (b) concerns
  - It is likely that the REIT group will need to enter into service agreements with the Non-REIT group for the provisions of services (e.g., accounting and treasury), while the Non-REIT group will need to enter into leases with the REIT group to cover properties used by the Non-REIT group
  - Consolidated group issues may arise to the extent restructuring includes deconsolidating a member (e.g., triggering of intercompany transactions and excess loss accounts)

REITs – restructuring issues (cont'd)

In order to meet the income and asset tests for REIT qualification, a U.S. group may often need to split itself between the "REIT" and "non-REIT" activities (cont'd)

- Because a REIT can hold up to 25% of its assets in TRSs, a company must strategically consider how to use this limit between domestic subsidiaries and CFCs
  - Consider potential transfer taxes and property tax revaluations on restructuring between REIT and TRS
- A REIT must distribute its C Corp E&P by the end of its first REIT year, so careful consideration needs to be given to E&P succession and allocation rules in tax-free restructuring, i.e. sections 312(h), 381, and Treas. Reg. sec. 1.1502-33(e)
- Ten-year built-in gain taint on sale of historic C Corp assets by REIT

REITs – REIT issues

The scope of what is included in “real property” and “rental of real property” can be complicated to determine

- The IRS has privately ruled that hotels/casinos, storage faculties, pipelines, and billboards can give rise to rental income from real property
- The IRS has also privately ruled that dividends from TRS and CFCs, as well as Subpart F and Section 956 inclusions from CFCs, can be treated as “dividends” for purposes of the 95% income test

REITs – REIT issues (cont'd)

The 90% distribution threshold can also give rise to issues

- Distributions can occur during the year as well as for the 12-month period following the close of the year (provided the distribution was declared prior to federal tax return filing date, with extensions)
- Distributions can be ordinary income or, to the extent attributable to capital gains, designated as capital gains
  - For shareholders, such capital gains would generally be long term capital gains
  - Such distributions can have Section 897 FIRPTA consequences
- In order to preserve cash within the REIT group, distributions can be made in a combination of cash and stock of the REIT, with a shareholder given the right to chose the form of consideration
  - The IRS has privately ruled that the cash component must be at least 20% of the consideration for such distributions

Use of master limited partnerships as a source of capital

Master limited partnerships – general U.S. tax principles

Under general U.S. federal income tax principles, a partnership is a flow-through entity. However, a publicly traded partnership (PTP) generally is treated as a "corporation" for tax purposes

- In general, the term "publicly traded partnership" means any partnership if interests in such partnership are either (i) traded on an established securities market or (ii) readily tradable on a secondary market (or the substantial equivalent thereof)
- Thus, a PTP is generally not an efficient means to raise public capital

However, there is an exception for PTPs if at least 90% of its gross income for a taxable year (and all preceding taxable years) consisted of qualifying income, which is defined in relevant part as

  - Interest
  - Dividends
  - Real property rents

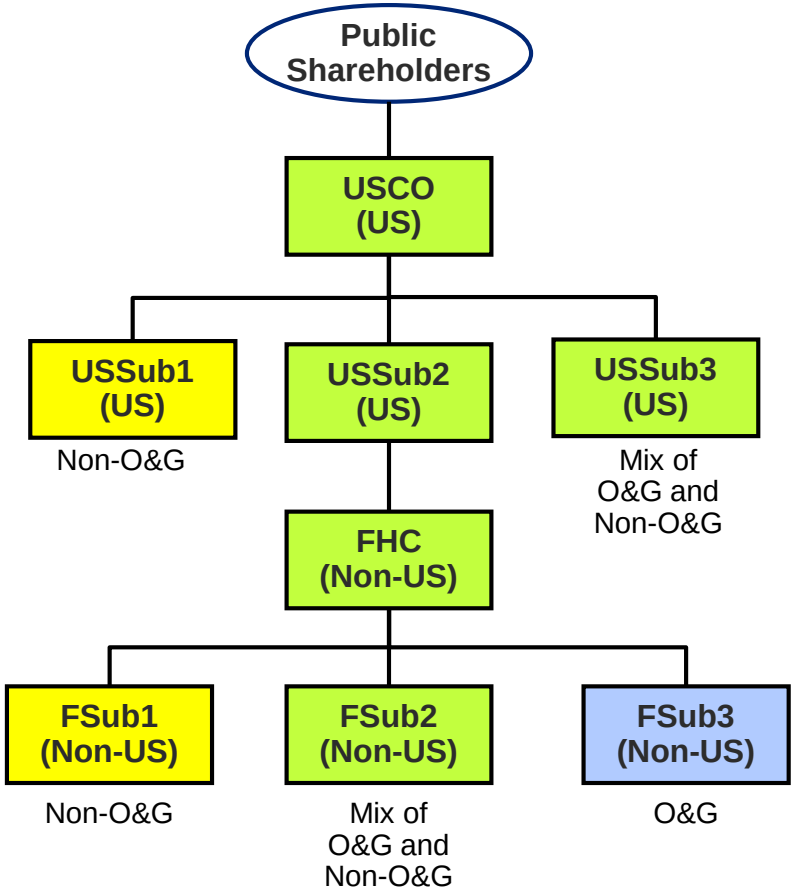
Master limited partnerships – general U.S. tax principles (cont'd)

However, there is an exception for PTPs if at least 90% of its gross income for a taxable year (and all preceding taxable years) consisted of qualifying income, which is defined in relevant part as (cont'd)

- Gains from disposition of real property (including if held as inventory)
- Income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber) industrial source carbon dioxide, or the transportation or storage of any fuel described in subsection (b), (c), (d), or (e) of Section 6426, or any alcohol fuel, or any biodiesel fuel

- A PTP, often referred to as a Master Limited Partnership (MLP), that satisfies this 90% gross income test is not treated as a corporation for tax purposes, so it has only a single level of U.S. federal income tax at the partner level, and, thus, an MLP can be a viable vehicle for raising public capital

MLPs to raise public capital

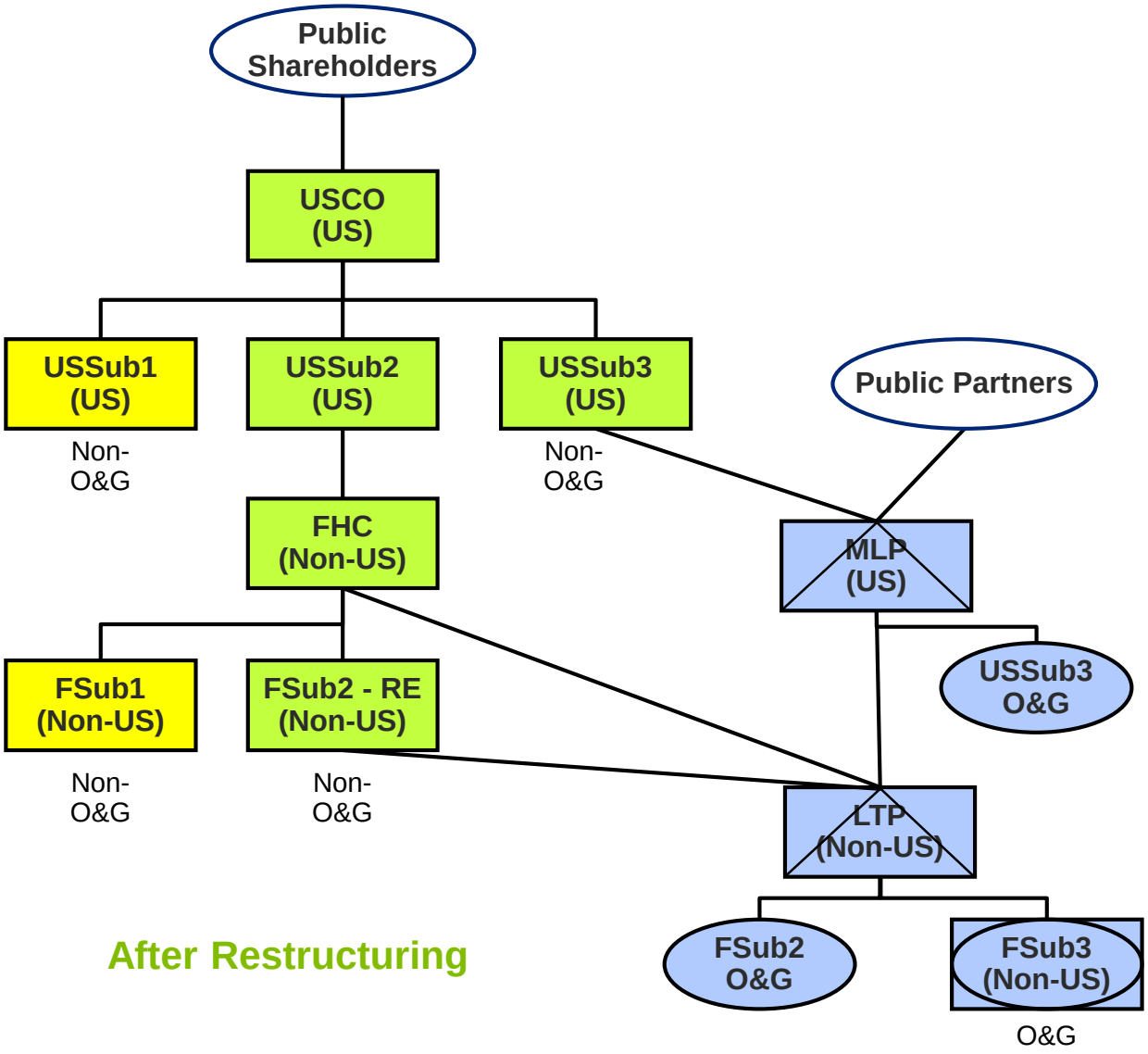


Before Restructuring

Relevant U.S. Tax attributes and activities

- USCO is a publicly traded U.S. corporation
- The USCO group holds oil and gas properties as well as conducts business activities involving those properties in addition to business activities unrelated to oil and gas
- Members of the USCO group are both U.S. and non-U.S.
- Some members of the USCO group hold only oil and gas properties (O&G), while other members hold only business operating assets (non-O&G) or hold both O&G and non-O&G

MLPs to raise public capital (cont'd)



MLPs – restructuring issues

In general, U.S. multinationals form MLP structures by contributing qualifying property to the MLPs, with public investors contributing cash to the MLPs

- In general, contributions of property to an MLP would be non-taxable under Section 721
  - However, assumptions of a contributing partner's liabilities by the MLP and/or the economic shifting of cash proceeds to a partner that has contributed property to the MLP could have taxable consequences under Section 707 (disguised sale rules)
- For non-U.S. properties, it is often better to have such properties contributed to a lower-tier partnership (LTP) formed in the jurisdiction where the foreign assets are located
  - This tends to limit tax costs in the local jurisdiction
  - The use of an LTP avoids the U.S. tax consequences of having CFCs distribute qualifying property up into the US (as a taxable dividend) before the contribution of such property to the MLP

MLPs – restructuring issues (cont'd)

- For non-U.S. properties, it is often better to have such properties contributed to a lower-tier partnership (LTP) formed in the jurisdiction where the foreign assets are located (cont'd)
  - An MLP will need to contribute part of the cash proceeds from Investors to the LTP in order to maintain an ownership interest in the LTP and to provide a valve for moving the non-US cash flows to the Investors
- It should be noted that investors generally want flow-through treatment. Consequently, if an entity is to be contributed to an MLP, that entity generally will need to elect (or convert into an entity that can elect) a flow-through entity classification. This could have both Section 332, Section 367 and Subpart F consequences
  - So that public investors will not have filing requirements in foreign jurisdictions, the entity will generally be taxed as a corporation in the foreign jurisdiction, despite being a flow-through for US federal income tax purposes.

MLPs – pros and cons

Benefits

- Source of new equity capital
- Premium valuation (uplift)
- Potential to defer upfront taxable gain (disguised sale exceptions)
- Advantaged cost of capital
- Retain operating control
- Upside through retained LP units, GP and incentive distribution rights (IDRs)
- Flexible structuring vehicle
- Acquisition currency

Considerations

- Complex tax and structural issues
- Shareholder base (Retail vs. Institutional)
- Incremental tax reporting requirements
- Yield-driven vehicle that requires high cash payout

MLPs – qualifying income and PLRs

The scope of what is included in “qualifying income” can be complicated to determine. Because the public market needs certainty that the MLP will not be taxed as a corporation (because it failed the 90% qualifying gross income test), if the MLP’s advisors cannot give it a “will” level of opinion on qualifying income, the MLP will ask the IRS for a private letter ruling (PLR)

- The IRS has privately ruled that many forms of natural resource activities, including pipelines and fracking activities, give rise to qualifying income
- In April 2014, the IRS announced a “pause” for PLRs with respect to certain MLPs, temporarily suspending the issuance of new PLRs on qualifying income unless they were “straight down the fairway”
  - Driven by recent volume of PTP ruling requests
  - Industry changes have increased the extent to which natural resource-related income is earned by outside contractors, which has caused the IRS to reconsider the scope of the qualifying income exception
    - IRS focused on whether income is “integrally related”

MLPs – qualifying income and PLRs (cont'd)

- In April 2014, the IRS announced a "pause" for PLRs with respect to certain MLPs, temporarily suspending the issuance of new PLRs on qualifying income unless they were "straight down the fairway" (cont'd)
  - The "freeze" was expected to last several months (similar to pause for REIT rulings in 2013), but has lasted substantially longer than the originally mentioned expectation for guidance in fall of 2014
  - The IRS is developing a standard helpful to taxpayers and expects to soon begin issuing PLRs and announce the form guidance will take in the spring of 2015

Please remember to complete your evaluation