Combining global liquidity management with effective tax management

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Agenda

- The perfect treasury structure
- Layers in a cash management model
- Today's treasury objectives
- Key drivers in the cash management arena
- Features & benefits of BMG's liquidity management proposition
- US federal income taxation of notional pooling structures
- Contact information

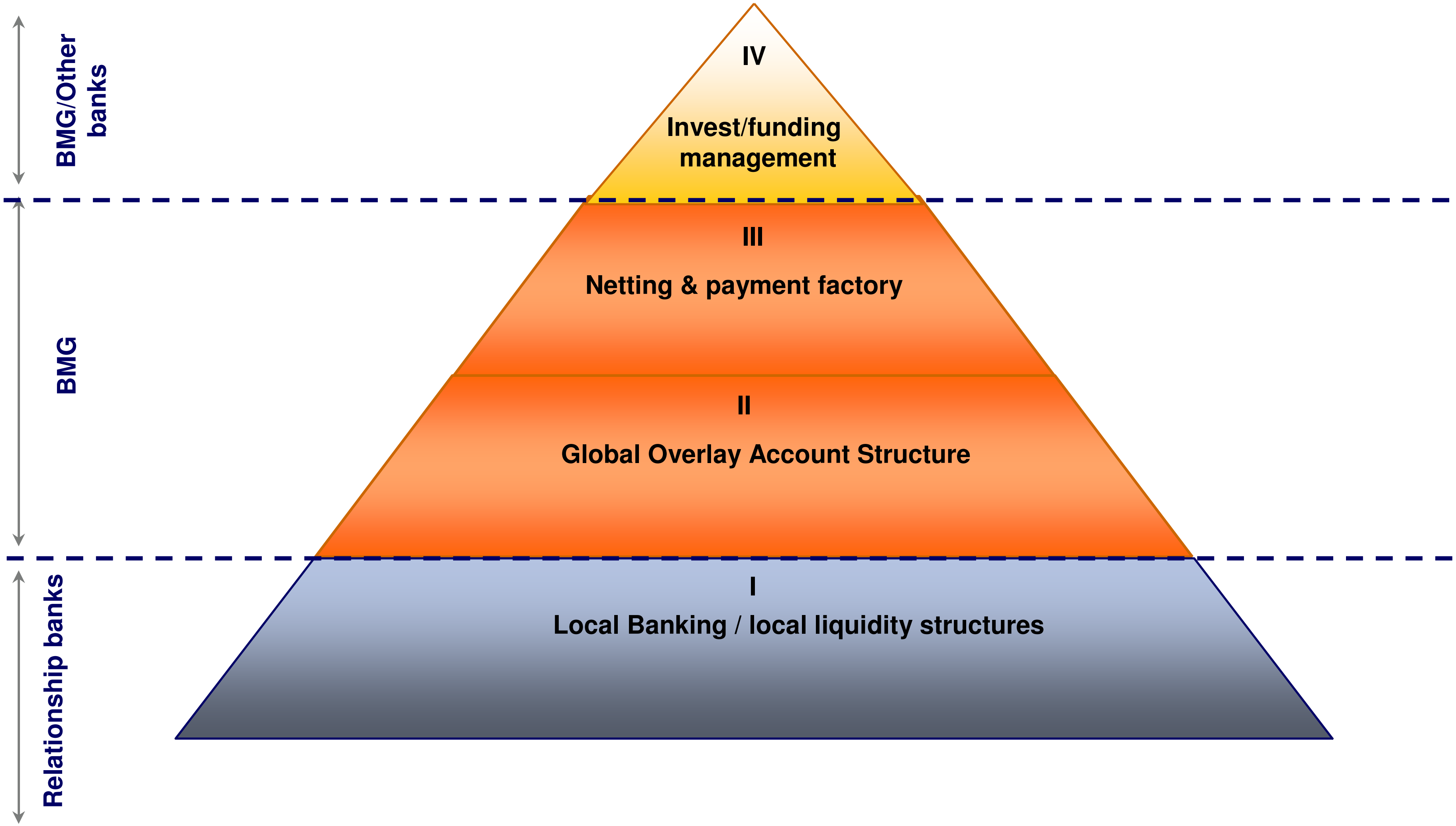
The "Perfect" Treasury Structure

- Policies Highly Visible
- Interactive Communications
- Plan, Actual & Forecast in sync
- Functions & Systems integrated
- Performance Metrics in Place to Demonstrate Value

Introduction Bank Mendes Gans

- Clear business model ; multi-bank & multi currency approach
- Excellent track record in global liquidity management & netting services
- Building long term relationships with multinationals worldwide

Layers in a cash management model



Today’s Treasury objectives

- **Increasing focus on global visibility & control**
- **Separate strategic treasury from operational treasury and consider outsourcing of operational workload**
- **Reduce working capital on global scale via simple and effective tool**

Review of treasury functions; strategic objectives

Cash Management

- Ensure effective payment process – ic & third party – to the group companies
- Maximise the use of funds within the group
- Integrate all local cash pools and non pooled accounts in one global structure
- Ensure cash visibility of all group liquidity with all banks

Financing

- Simplify and standardize the intercompany financing procedures

Forex

- Simplify central FX management
- Ensure forecast of foreign currency payables via FX exposure reporting tool

Key drivers in the cash management arena

Quality

- **Set up state of the art treasury with performance measurement indicators**
- **Use state of the art technology to be rolled out globally**
- **Ensure flexibility towards the future**

Speed

- **Speed of implementation; starting with global back bone**
- **Connect group companies and/or pool leaders directly to global back bone**
- **Avoid domestic pool if possible and connect directly to global back bone**

Costs

- **Reduce external bank costs; transfer fees related to payments**
- **Reduce internal costs; payment processing, in-house bank, loan doc**

Is outsourcing the answer?

- **Which partner to select**

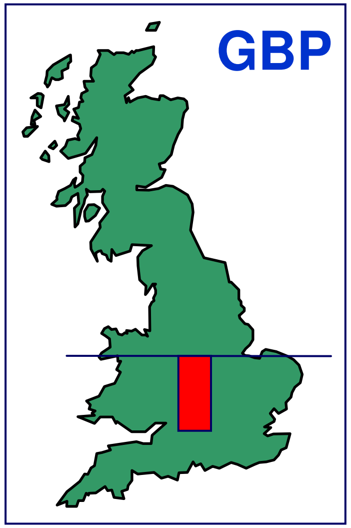
- **Conduct a feasibility study demonstrating the costs / benefits of an outsourced solution**

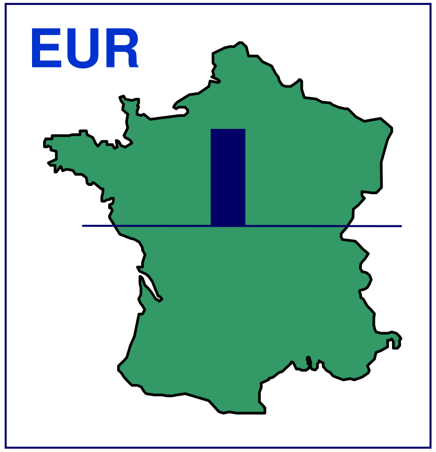
Identify functions to be outsourced

- **Liquidity management process : Overlay cash pool**
- **Intercompany / third party payment process : Netting**
- **Intercompany financing process : Intercompany loan portfolio**
- **In-house bank set up : Internal current account structure**

In the presentation we will further focus on the features & benefits of the overlay cash pool

Without a global overlay structure





- **Decentral liquidity**
  - Not possible to use credit balances to offset debit balances
- **2 options available**
  - Local pools, local MM
  - Centralize it yourself by using FX and I/C loans

Building a global overlay structure

- **Notional Cash pool; avoiding inter-company loans**
  - Local cash balances of the group companies are centralized at BMG in *their own accounts*

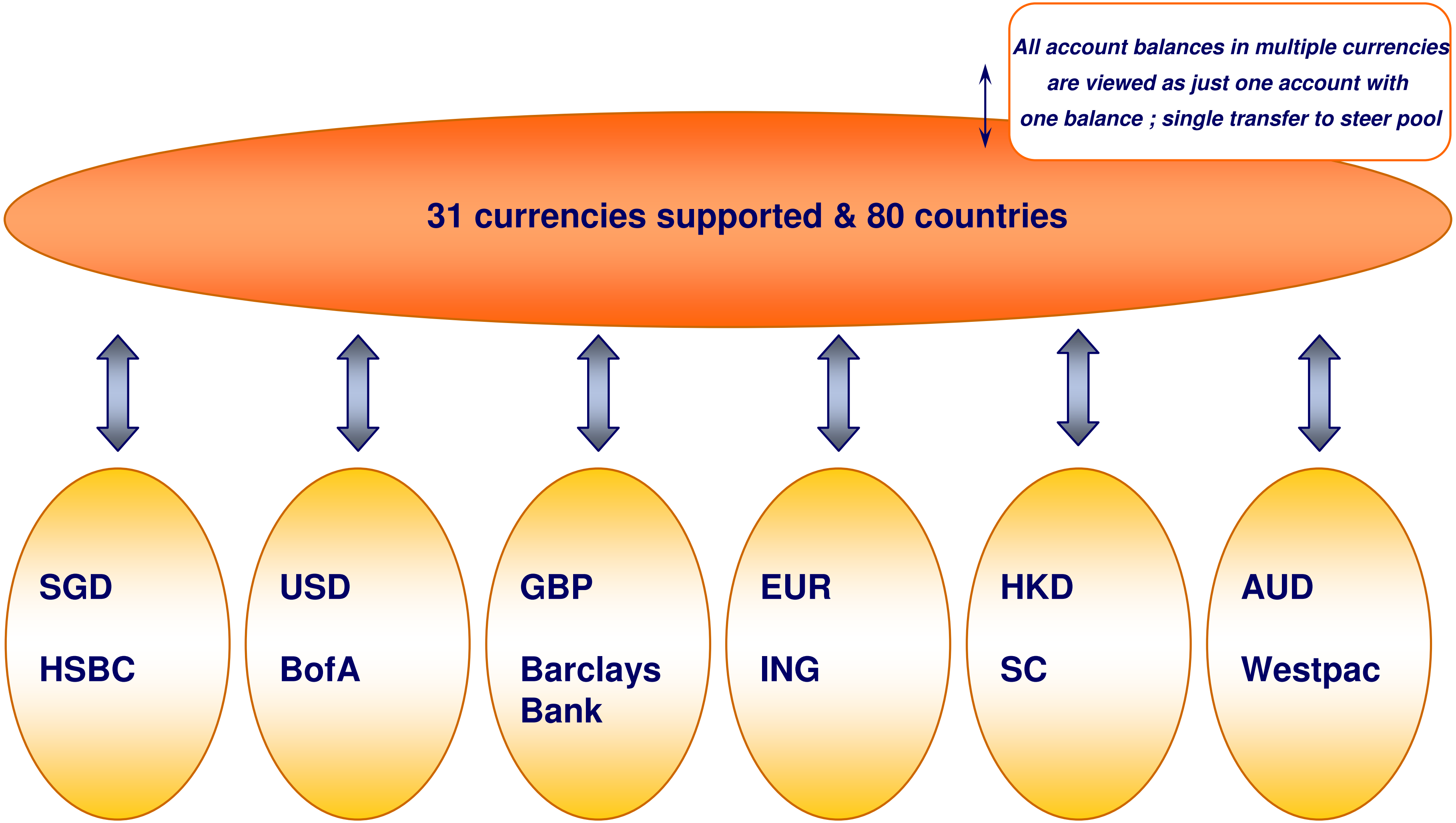
- **Zero balancing cash pool: creating inter-company loans**
  - Local cash balances of the group companies are centralized at BMG in e.g. *Finance company accounts*

- **Two simple variations which can easily be mixed!**

In the presentation we will further focus on the features & benefits of a notional overlay cash pool

Building a “notional”overlay solution

multi-bank, multi-currency, no additional local bank accounts

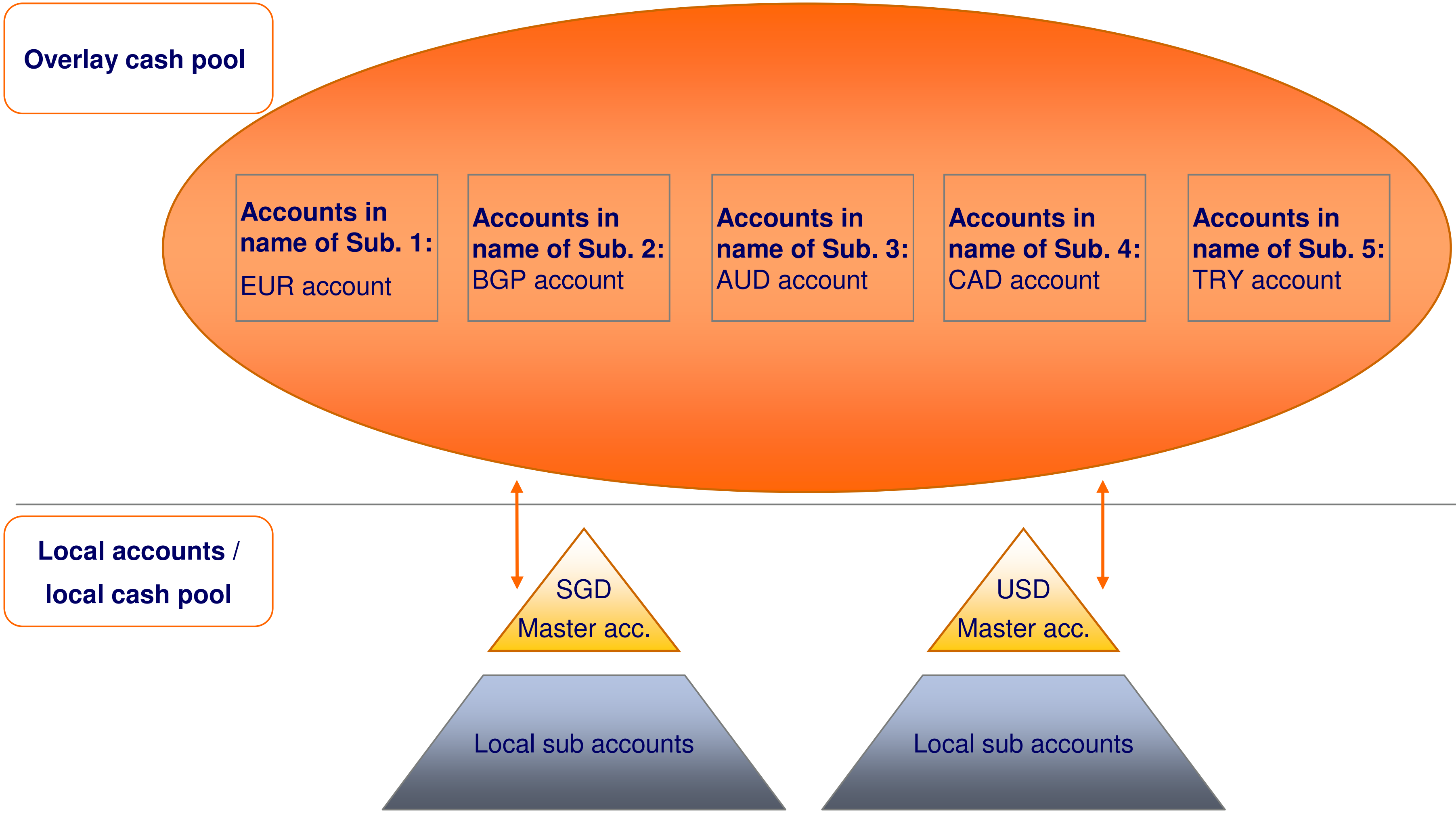


Currencies supported in the overlay cash pool

region	*country*	*currency*	*region*	*country*	*currency*
Europe	Euro-zone	EUR	Americas	USA	USD
	United Kingdom	GBP		Canada	CAD
	Switzerland	CHF		Mexico	MXN
	Turkey	TRY	Asia & Pacific	Japan	JPY
	Czech Republic	CZK		Hong Kong	HKD
	Poland	PLN		Singapore	SGD
	Hungary	HUF		Australia	AUD
	Romania	RON		New Zealand	NZD
	Bulgaria	BGN	Middle-East &		
	Russia	RUB	Africa	Bahrein	BHD
	Norway	NOK		Saudi Arabia	SAR
	Danmark	DKK		United Arab Emirates	AED
	Sweden	SEK		Kuweit	KWD
	Latvia	LVL		Israel	ILS
	Lithuania	LTL		South Africa	ZAR
	Estonia	EEK		Tunisia	TND

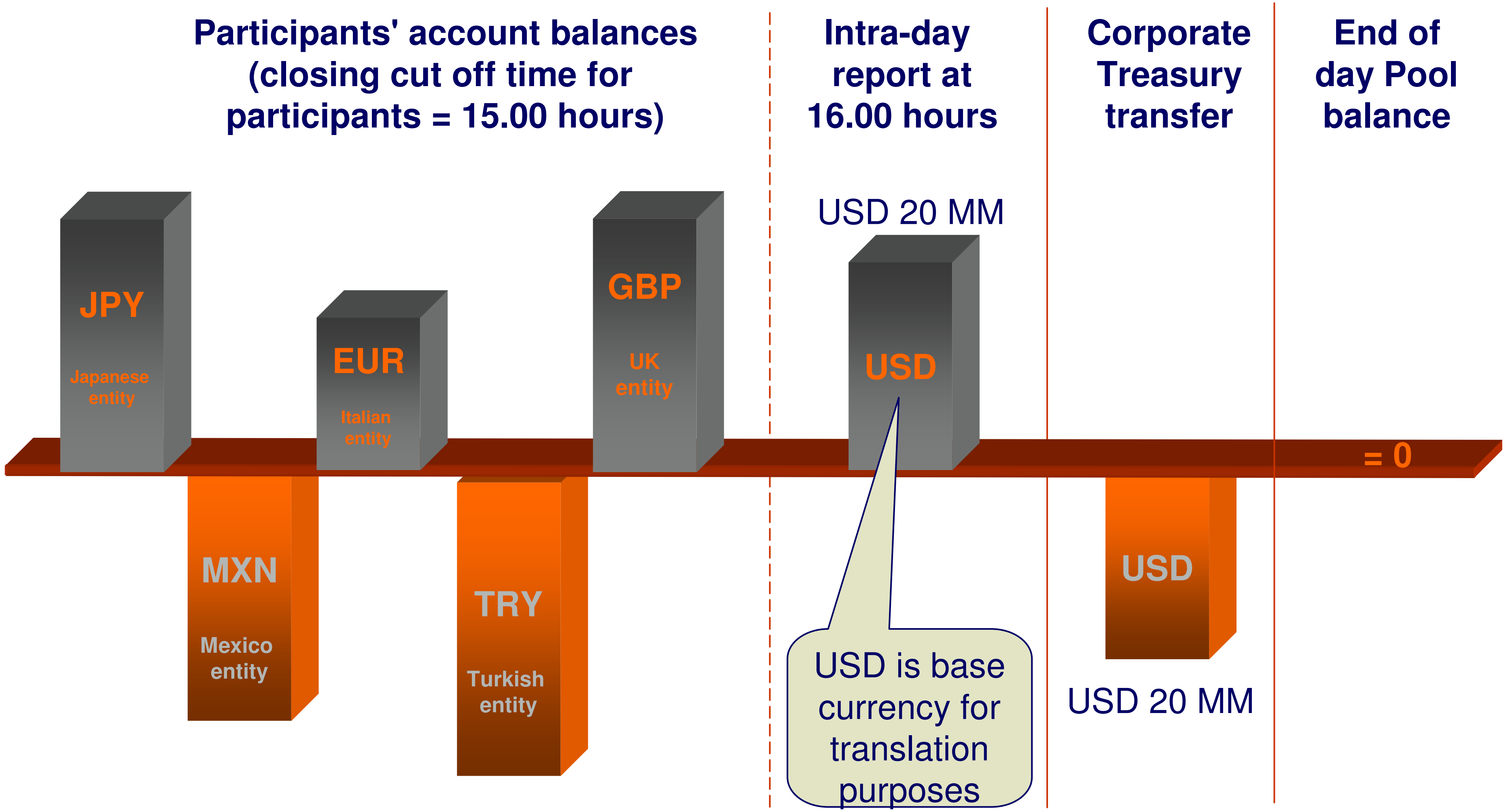
Example: "multi entity" account structure

no change of ownership



Example of notional cash pool operation

how corporate treasury manages the cash pool



US Federal Income Taxation

Introduction

- **THIS DOCUMENT EXPRESSES NO OPINION REGARDING THE TAX CONSEQUENCES OF ANY STEP AND STRUCTURE DISCUSSED HEREIN AND SHOULD NOT BE CONSTRUED AS SUCH. BEFORE IMPLEMENTING ANY STRUCTURE OR ENGAGING IN ANY TRANSACTION PLEASE CONSULT YOUR TAX ADVISER. <u>THIS DOCUMENT IS FOR PRESENTATION PURPOSES ONLY</u>**

- **This presentation shall discuss certain international operations of MNCs. However, it is not intended to be an exhaustive summary of all possibilities. For purposes of this presentation certain assumptions shall be made from time to time given the extremely detailed nature of the subject. For example when speaking of the applicability of the foreign personal holding company income rules of subpart F, it may be assumed that certain exceptions (e.g. high tax exemption or the 'de minimis' exception) are not met**

- **All information, structures described and the proposed steps are purely fictitious and any resemblance with any individual or legal entity is merely coincidental**

- **CIRCULAR 230 NOTICE: Under the applicable Treasury regulations we are required to inform you that any information in this communication is not intended or written to be used, and cannot be used, by a client or any other person or entity for the purpose of avoiding penalties that may be imposed on any taxpayer or promoting, marketing or recommending to another party any matters addressed herein. Please note that this presentation may be subject to disclosure to various authorities in the jurisdictions in which the company (will) operate(s)**

The basics

- **This section primarily addresses the US federal income tax consequences associated with the implementation of cash pooling arrangements by US owned multinational groups. This section is mainly concerned with the US tax implications to the US parent of the multinational group where one or more of the foreign subsidiaries are controlled foreign corporations ("CFC") as defined herein**

- **US multinationals may face a variety of US federal income tax issues if they decide to implement an international cash pooling structure. Among these issues are:**
  - Availability of the foreign tax credit to avoid double taxation
  - Subpart F – anti deferral regime
  - Foreign country taxes

The basics

- Under the US "worldwide" taxing system, foreign subsidiary earnings are generally taxed only upon repatriation to the US as dividends. Under an exception to the general rule of "deferral", certain kinds of foreign subsidiary earnings (e.g., passive) are taxed currently as "deemed" dividends (Subpart F)

- If a US company repatriates all of its foreign earnings, it will ultimately pay at least the US rate of tax on its aggregate foreign-sourced earnings

- To avoid double taxation of foreign earnings (i.e. the foreign earnings would be subject to tax in the foreign jurisdiction and the U.S.), the U.S. generally grants a foreign tax credit for foreign taxes paid

- The applicability of the foreign tax credit and the amount is subject to a highly complex set of rules. In the next slides we will highlight some of the more prominent features hereof which are of particular interest in connection with centralized treasury management structures

The basics

- **In principle a taxpayer can operate its foreign business ventures in two main ways:**
  1. through a foreign branch – the income is directly included in the owner's income
  2. through a foreign corporation – the income is not includable until repatriated through distribution
  3. through a partnership or so-called hybrid entities – This is set to change under the Obama Proposal (see below)
- **When the income of a domestically held foreign corporation is repatriated, the US corporation may be entitled to a credit for income taxes paid by the foreign corporation by the indirect tax credit mechanism**
- **The income earned by a foreign corporation is generally speaking not imputed to its shareholders. Taxation on the income earned by a foreign corporation is consequently in principle deferred.**
- **<u>However</u>, under the rules of subpart F the income of certain foreign corporations is under certain circumstances imputed to shareholders. This aims to reduce the ability for taxpayers to defer US taxation by accumulating earnings offshore**

Foreign tax credit
mitigation of double taxation

- **The foreign tax credit is available only for foreign income taxes and is subject to a variety of limitations**
- **The "overall" limitation provides that the total amount of the foreign tax credit cannot exceed the same proportion of the tax against which the credit is taken which the taxpayer's foreign source taxable income bears to worldwide taxable income**
- **When certain conditions are met an "indirect" foreign tax credit is available under §902 for the foreign taxes incurred at the level of the foreign subsidiaries of the US corporate shareholder**
- **The rationale hereof is to create tax parity between branches and subsidiaries**

- **Formula:** $\dfrac{\text{Pre-credit}}{\text{US tax}} = \dfrac{\text{Foreign source taxable income}}{\text{Total taxable income}}$

Passive income

- **One of the restrictions of the foreign tax credit regime is that the foreign sourced income is divided in two main classes; passive and active.**

- **Since most passive income is considered to be easily ‘moved’ around to lower taxed environments (e.g. the Irish IFSC), the low taxed income can in principle not be blended with the high taxed active business income**

- **In practice, an MNC with passive income may incur a residual US tax liability on such passive income if repatriated**

- **Passive income in general includes interest income. It is therefore important to structure a cash pool in a way whereby passive income is avoided**

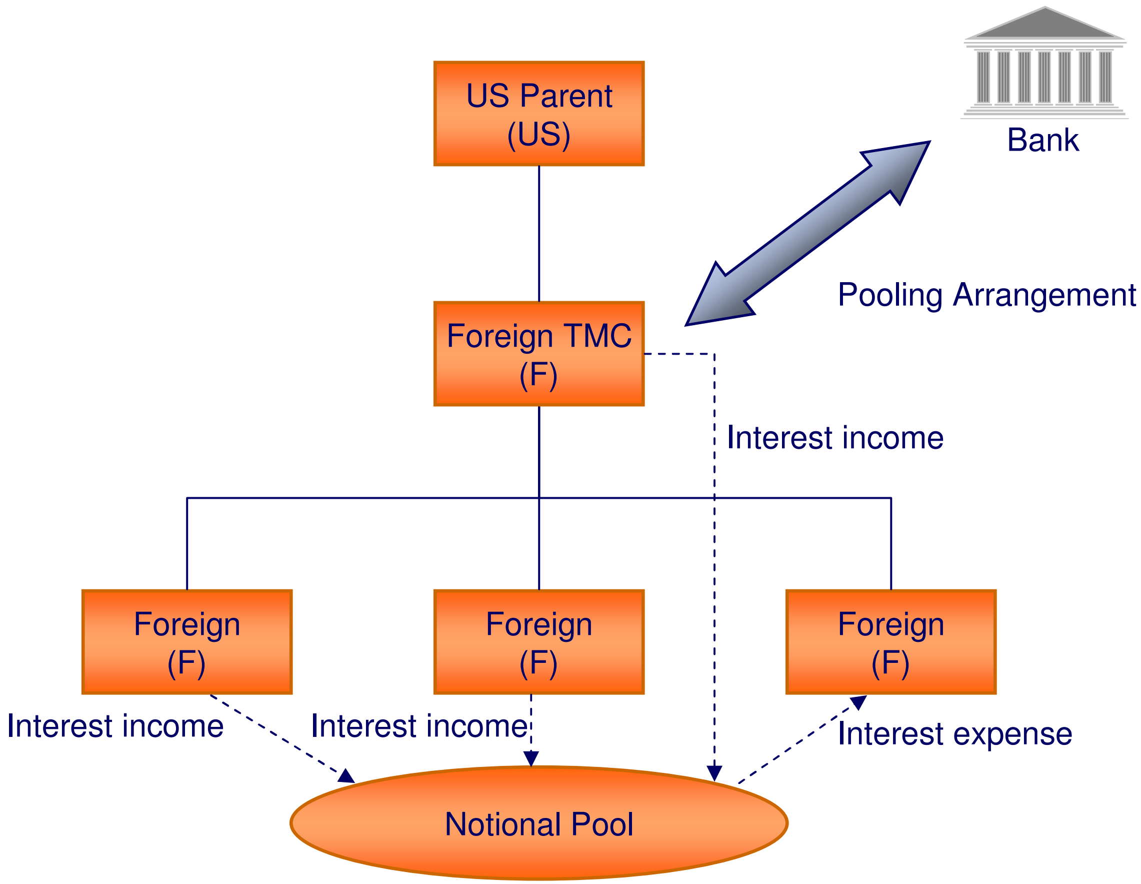
- **There are several exceptions to the passive income classification. Relevant exceptions to passive income classification for interest (both related party and bank interest)**

Subpart F

- **Certain income earned by foreign subsidiaries (CFCs) of US MNCs needs to be directly included in income by the US parent of the MNC under the rules of subpart F**
- **In general, as with passive income, interest is included in subpart F. It is therefore important to structure a cash pool in a way whereby subpart F is avoided**
- **Items of interest:**
  - **Bank interest - this is in principle both passive and subpart F**
  - **Related party interest - this is in principle both passive and subpart F**
- **In the next slides we will provide an overview of the treatment from a US federal income tax perspective of a notional cash pool**

Notional cash pooling structures
example

- **In a notional pooling structure, each participant maintains its own bank account and incurs interest expense and recognizes interest income depending on the balance of the account**
- **Generally, the US tax consequences of a notional pooling structure are not significantly different than those where the group companies maintain and manage cash on a stand alone basis and do not participate in a notional pool**
- **However, under circumstances it may be beneficial to create a hybrid structure to eliminate the differences in tax attributes of the various group companies. This may allow to offset interest income of one group entity which may be of a passive nature with the interest expenses paid by other group companies**



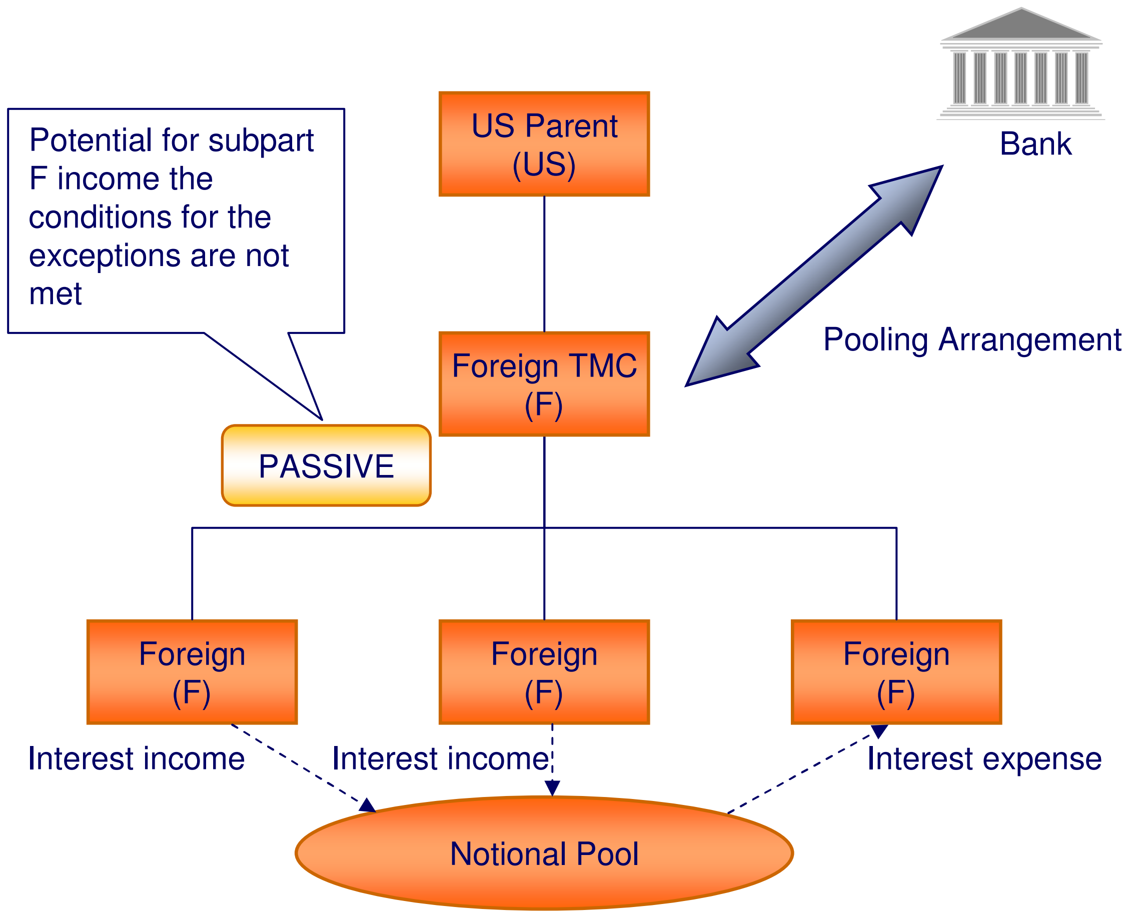
Notional cash pooling structures

example

- **If the individual participant's balance in the cash pool is in a surplus position, the following should occur**:

  1. The participant earns bank interest which may be passive in nature if the conditions for the exceptions are not met

  2. This bank interest may be subpart F if the conditions for the exceptions are not met



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Foreign tax credit – Obama's new plans

- On May 4, 2009, the Obama Administration released more details on its intention as expressed in the February 26, 2009 Budget Proposal to raise $210 billion through international tax reform and enforcement ("Proposal")
- On May 11, 2009, the Treasury issued a 'Greenbook' elaborating the May 4, 2009 proposal
- Generally, the Revenue Proposal states that the provisions in the May 11, 2009 Proposal would be effective for years beginning in 2011
- The Proposal would significantly alter the foreign tax credit regime

Foreign tax credits under Obama

- In contrast to the Rangel Bill of 2007, the Proposal would not treat all CFCs as one entity and thus creating extremely complex consolidation rules (compare Regs. §1.1502)
- All earnings and Profits (E&P) and foreign taxes of all eligible entities would be aggregated or 'pooled'
- This pooling in principle leads to an automatic blending of foreign income and taxes
- The deemed-paid FTC would be based on an amount of aggregated E&P that is repatriated
- Further rules would prohibit the separation of income and taxes
- As a result, a credit is allowed only for the same portion of foreign taxes for the year that equals the amount of earnings repatriated by one or more CFCs over total foreign earnings, repatriated as well as deferred (CTFI + DFI). This will in many cases substantially reduce the amount of the credit for the year

Participation by US parent in the cash pool
deemed dividend

- **Participation by the US parent or any US group companies of the MNC in the centralized treasury management system remains problematic due to the deemed dividend rules**
- **Generally, every US shareholder of a CFC shall include in gross income as a deemed dividend the shareholder's pro rata share of the CFCs increase in earnings invested in US property**
- **US property includes an "obligation" of a US person**
- **The Regulations provides that an "obligation" includes any bond, note, debenture, account receivable, open account or other indebtedness. It is not relevant whether the US corporation pays interest thereon**

Participation by US parent in the cash pool

exceptions for US obligations – Notice 2008-91

- **In Notice 88-108 (1988-2 C.B. 445) the Treasury Department announced that US obligations would exclude obligations that are collected within 30 days from the time they are incurred**

- **However this exclusion shall not apply if the controlled foreign corporation holds for 60 or more calendar days during such taxable year obligations that without regard to the 30 day rule described in the preceding sentence, would constitute an investment in US property if held at the end of the controlled foreign corporation's taxable year**

- **In 2008 the period of collection was increased to 60 days from the time it is incurred. However, this exclusion shall not apply if the controlled foreign corporation holds for 180 or more calendar days during its taxable year obligations that without regard to the 60 day rule described in the preceding sentence, would constitute an investment in US property**

- **This notice applies, if a foreign corporation has a calendar tax year, for the foreign corporation's taxable years ending December 31, 2008, and December 31, 2009**

Treatment of guarantees & pledges

parent guarantee

- **Most financial institutions require the parent company of the group (i.e. the US MNC) to provide a guarantee for any outstanding obligations of its group members derived out of (i) the general business accounts, and (ii) the credit balances in a pooling structure**

- **The guarantor is normally regarded as having a secondary liability as having guaranteed the indebtedness to the maker**

- **The guarantee by the parent company of the group should result in an inter company charge of a fee to the subsidiaries benefiting from the guarantee based upon the arm's length principles of §482**

- **Based upon the facts and circumstances of the particular case, the IRS may attempt to recharacterize a guarantee as an equity interest or as a primary obligation. If the nominal borrower(s) is (are) adequately capitalized and otherwise able to borrow funds on an independent basis the courts should respect the form of the arrangement as a true guarantee**

Treatment of guarantees & pledges

bank pledges

- **Under substance-over-form principles similar as applied in *Plantation Patterns*, the Service may reclassify the existing relationship with a bank to that one with a group entity**

Long term financing

- **Although a full discussion of the implications of long-term financing for US MNC's is outside the scope of this document, we highlight certain elements relating to notional pooling structures**
- **It is not uncommon for the US parent company to fund the cash pool through a facility. The use of this cash by the participating entities should in principle result in inter company loans from the US parent to the participating entities**
- **An alternative way to structure this is to fund the pool through a capital contribution to the TMC, this way the funds can be permanently invested**
- **Long term financing of the participating entities through the notional pool without intervention by the parent company is problematic as from an economic perspective the other participating entities make their cash available on a permanent basis to the borrowing entity. Adequate structuring may reduce this risk**

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