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M&A Tax, International Tax & Tax Accounting Update

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HIGHLIGHTS

Final OECD Base Erosion and Profit Shifting ("BEPS") Reports Released

On October 5, the OECD released 13 final reports detailing 15 proposed action items under the base erosion and profit-shifting ("BEPS") project. The BEPS final reports are the culmination of a multi-year project designed to address perceived abuses under current international tax systems. The OECD will present the final reports to the G-20 leaders for final approval during their November 15-16 summit. Two of the reports are discussed in more detail below.

The Recently Enacted Budget Deal Includes Sweeping Changes to Partnership Audit Rules

At the end of October, Congress passed the Bipartisan Budget Act of 2015 (the "Budget Act"), which would repeal existing TEFRA and large partnership audit rules and replace them with a single system in which audits generally are conducted at the partnership level and audit adjustments result in payments made to the government directly by partnerships. The Budget Act includes an opt-out provision for partnerships with 100 or fewer partners, but the opt-out is not available where any of the partners are partnerships themselves. The default rule in the Budget Act calculates understatements of tax as the product of the audit adjustment and the highest marginal tax rate, but the Budget Act allows for reductions where partners are tax-exempt or otherwise subject to a lower marginal tax rate. Critics of the new rule have raised the unfairness of imposing the consequences of an audit adjustment on a partnership's current partners, rather than its partners as of the taxable year to which the adjustment relates, though the Budget Act allows for

IN THIS ISSUE

1. Final OECD BEPS Reports Released
2. The Recently Enacted Budget Deal Includes Sweeping Changes to Partnership Audit Rules
3. MGM Resorts Plans to Form REIT
4. BEPS Action Item #13 Deals with Transfer Pricing Documentation and Country-by-Country Reporting
5. BEPS Action Item #14 Deals with Dispute Resolution Mechanics
6. Dell Agrees to Acquire EMC for Cash and Tracking Stock
7. Private Letter Ruling Released in Reverse Morris Trust Transaction

the partnership to elect to have its historic partners pay the tax liability themselves. Many of the details of these exceptions to the default rule are left to future regulations. The partnership audit provisions in the Budget Act are scored to raise almost $1 billion per year in revenue. President Obama is expected to sign the Budget Act into law on November 2.

MGM Resorts Plans to Form REIT

MGM Resorts International announced plans to form a REIT that will own ten MGM Resorts properties. The REIT will be owned 70% by MGM Resorts and 30% by the public. This structure is different from the "opco-propco" spin-off transactions a number of publicly traded companies have entered into during the last couple of years. In an "opco-propco" structure, an operating company ("opco") contributes its real estate to a newly formed subsidiary ("propco") and then distributes the propco to its shareholders in a tax-free spin-off under section 355 of the Code. After the spin-off, each of the opco and propco is owned by public shareholders, and the propco elects to be taxed as a REIT. The propco then generally leases its real estate back to the opco under a long-term triple net lease. Under Rev. Proc. 2015-43, the IRS has stated that it will not ordinarily rule on spin-offs followed by REIT elections while it considers issuing published guidance. The MGM Resorts transaction appears to be a compromise relative to an opco-propco spin-off. Although the tax benefits are less than what they could be in a complete opco-propco spin-off, the transaction arguably has less tax risk and presents fewer corporate governance complications.

BEPS Action Item #13 Deals with Transfer Pricing Documentation and Country-by-Country Reporting

The OECD's goal in Action 13 ("Guidance on Transfer Pricing Documentation and Country-by-Country Reporting") is to develop transfer pricing documentation rules that enhance transparency for tax administration while taking into consideration the compliance costs and privacy concerns of businesses. The report provides a three-tier reporting mechanism for multinational enterprises to provide, according to a common template, all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries.

This three-tier reporting system consists of:

1. A master file containing a high-level overview of the multinational's global operations and policies that is provided to all relevant tax authorities.

2. A local file providing detailed information concerning intercompany transactions including transfer pricing documentation specific to each country and an analysis of transfer pricing determinations relevant to that country.

3. A country-by-country report providing the amount of revenue, profit before tax, and income tax paid and accrued for each tax jurisdiction in which the multinational conducts business, as well as numbers of employees, tangible assets and capital structures in each tax jurisdiction. Country-by-country reports should be filed in the ultimate parent entity's jurisdiction and shared automatically through government-to-government exchange of information under existing tax treaties or tax information exchange agreements.

The report recommends that reporting requirements be implemented for fiscal years beginning on or after January 1, 2016 and apply to multinationals with annual consolidated revenues of at least €750 million. Treasury estimates that more than 1,600 U.S.-based multinationals meet this revenue threshold. Representatives of LB&I have stated that temporary regulations to implement country-by-country reporting will be released by the end of 2015.

BEPS Action Item #14 Deals with Dispute Resolution Mechanics

The changes introduced by the BEPS project may well increase the risk of double taxation and the need for resolution of disputes between taxing jurisdictions. Under Action 14 ("Making Dispute Resolution Mechanisms More Effective"), OECD countries have committed to adopt a minimum standard with respect to resolving treaty-related disputes. This includes a political commitment to an effective and timely resolution of disputes through a mutual agreement procedure ("MAP"), as well as the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes. The report also includes the establishment of a monitoring mechanism to ensure the minimum standard is met and countries make further progress to rapidly resolve disputes.

The report acknowledges there is no consensus on adopting binding arbitration to resolve transfer-pricing disputes, something favored by the U.S. government and the business community. Twenty countries (comprising more than 90 percent of outstanding MAP cases at the end of 2013) have committed to adopt mandatory and binding arbitration in their bilateral tax treaties.

Dell Agrees to Acquire EMC for Cash and Tracking Stock

Dell Inc. has agreed to acquire EMC Corp. for a combination of cash and tracking stock of VMware Inc., a publicly traded company of which EMC owns more than 80% of the outstanding stock by vote and value. According to publicly filed documents, the shareholders of EMC and Dell will engage in transactions in which each is treated as contributing its stock to a new holding company ("Holdco") in exchange for stock and/or cash in a transaction intended to qualify as tax-free under section 351 of the Code. The Holdco stock issued to EMC shareholders in the transaction will actually be VMware tracking stock. In other words, even though the VMware tracking stock is issued by Holdco and intended to be treated as stock of Holdco for federal income tax purposes, the value of the tracking stock is supposed to reflect solely the economic performance of the VMware business. Between the VMware stock currently held by the public and the VMware tracking stock that will be held by former shareholders of EMC after this transaction, more than half of the economic value of the VMware business is expected to be in the hands of the public. Nonetheless, according to publicly filed documents, Dell expects EMC and VMware to be a part of Holdco's consolidated group following this transaction.

Tracking stock was popular in the 1990s when it was thought of as a means of spinning off a company without actually completing a spin-off. However, it has waned in popularity in the past decade. Perhaps others will now consider using it as consideration in M&A deals.

Private Letter Ruling Released in Reverse Morris Trust Transaction

In a private letter ruling (PLR 201542004) that has facts similar to the recently announced transaction between Dow Chemical and Olin Corp., IRS ruled on certain significant issues regarding a spin-off followed by a merger of the spinco with a third party's merger sub. Among the significant issued addressed, IRS ruled that it would treat an exchange of spinco securities for debt of the distributing corporation intermediated by certain financial institutions as an exchange qualifying for non-recognition under section 361(c). These so-called "securities for debt" exchanges continue to be the most common means by which companies undertaking tax-free spin-offs insert leverage into the spinco. Such transactions are currently on the government's priority guidance plan. In the absence of any formal IRS guidance on these transactions, taxpayers generally do not engage in such transactions without obtaining a private letter ruling. IRS has granted a number of such private letter rulings in recent years, and this recent ruling is an indication that they are still available while IRS considers what guidance to issue.

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Litigation Update

Taxpayers in *Florida Bankers Ass'n v. Treasury* (see our September update) filed a petition with the D.C. Circuit Court for a rehearing *en banc*. The Court ordered the government to file a response to the petition; and the government did so.

AIG in *Bank of N.Y. Mellon v. Commissioner* (see our October update) filed a petition for a writ of certiorari to the U.S. Supreme Court.

Parties in *U.S. v. Microsoft* (W.D. Wash.) filed supplemental briefs regarding legality of IRS hiring private law firm to provide audit and litigation related services.