

UPDATES & OTHER TIDBITS

Authors

Elizabeth V. Zanet
Nina Krauthamer

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“CASH POOLING” UNDER ATTACK AS PART OF EARNINGS-STRIPPING RULES

Cash pooling involves a special structure, known as a “treasury center,” which is used by companies that are members of a multinational group of companies to pool excess cash in one bank, so that it can be made available to other group members in need of short-term liquidity. The cash pooling system provides subsidiaries with easy access to internal funding without the problems and expense of going to outside banks. In general, cash pooling arrangements are meant to provide short-term loans. These typical cash management strategies are now under attack.

On April 4, 2016, the Treasury Department issued proposed regulations under Internal Revenue Code (“Code”) §385,¹ known as the “earnings-stripping” rules, intended to limit companies from shifting or “stripping” income outside the United States through loans made to subsidiaries. The proposed regulations would characterize as equity a broad range of debt between related parties, including (i) notes distributed to a related shareholder, (ii) notes issued to acquire equity of a related entity, and (iii) notes distributed to a related entity in an asset reorganization. In order to support the treatment of an instrument as debt, taxpayers would be required to provide contemporaneous documentation, describing the commercial terms of the lending and providing an analysis of the creditworthiness of the borrower. If the documentation is not provided within 30 days, the financing would generally be characterized as equity.²

Practitioners have reacted to the earnings-stripping rules’ long reach by stressing to the Treasury Department that cash pooling is not any kind of tax planning, but a routine and practical way of doing business for large multinationals. Many have recently urged for a cash pooling carve-out in the proposed regulations. It remains to be seen what the Treasury Department will do when the proposed regulations move into the finalization stage.

TREASURY ANNOUNCES ACTIONS TO STRENGTHEN FINANCIAL TRANSPARENCY

Though many countries are adopting tougher measures to combat tax evasion and money-laundering, some observers have stated that the U.S. tax and legal systems

¹ REG-108060-15.

² See Philip R. Hirschfeld’s article “Related-Party Debt: Proposed Code §385 Regulations Raise Major New Hurdles,” in this month’s edition of *Insights*, for an expanded discussion of the new proposed rules.

provide foreigners with opportunities to legally hide income from their governments.

In a recent public statement, Treasury Secretary Jacob J. Lew announced several actions to strengthen financial transparency and combat the misuse of companies to engage in illicit activities, namely (i) a customer due diligence (“C.D.D.”) Final Rule, (ii) proposed beneficial ownership legislation, and (iii) proposed regulations related to foreign owned, single-member limited liability companies (“L.L.C.’s”).³



The C.D.D. Final Rule, issued by the Financial Crimes Enforcement Network (“FinCEN”) under the Bank Secrecy Act, adds a new requirement for financial institutions, such as banks, brokers or dealers in securities, and mutual funds, to collect and verify the personal information of the real people (*i.e.*, the beneficial owners) who own, control, and profit from companies when those companies open accounts. Further, under the final rule, financial institutions will have to identify and verify the identity of any individual who owns 25% or more of a legal entity, and any individual who controls a legal entity.

The beneficial ownership legislation sent to Congress by the Obama Administration would require companies to know and report adequate and accurate beneficial ownership information at the time of a company’s creation, so that the information can be made available to law enforcement. Companies formed in the U.S. would be required to file beneficial ownership information with the Treasury Department or face penalties.

The Treasury Department published proposed regulations on May 10, 2016. Among other things, unless certain exceptions apply, foreign owned, single-member L.L.C.’s would be required to obtain an employer identification number from the Internal Revenue Service (the “I.R.S.”) and to file information returns reporting transactions between the L.L.C. and its foreign parent. These regulations are aimed at a narrow class of U.S. entities – usually foreign owned, single-member L.L.C.’s – that have no obligation to report information to the I.R.S. but may be used to shield foreign owners of non-U.S. assets and non-U.S. bank accounts. The Treasury secretary stated that, “once the regulations are finalized, they will allow the I.R.S. to determine whether there is any tax liability, and if so, how much, and to share the information with other tax authorities.”

I.R.S. COMMISSIONER KOSKINEN ANNOUNCES NEW HIRING IN ENFORCEMENT AREAS

The operating budget of the I.R.S. has decreased by more than \$900 million since 2010. The constrained budget has led to a significant decline in the number of employees. Earlier this year, the I.R.S. received \$290 million from Congress for hiring 1,000 employees for its taxpayer telephone assistance service and adding reinforcement in the areas of taxpayer services, identity theft, and cybersecurity.

In early May, Commissioner Koskinen announced that the I.R.S. had enough resources to hire between 600 and 700 new employees in the enforcement areas. The primary motivation for the increase in hiring resources is the large number of

³ Department of the Treasury, “Treasury Announces Key Regulations and Legislation to Counter Money Laundering and Corruption, Combat Tax Evasion,” press release, May 5, 2016.

retirees and high overall attrition rate among enforcement employees. This new hiring opportunity will mark the first significant hiring of enforcement personnel in more than five years.

Koskinen stated that there will be two waves of job announcements. The first wave will begin in the next few weeks, with announcements being posted internally and externally for many entry-level positions. First-wave hiring will include revenue agents, revenue officers, and other enforcement positions, primarily in the Small Business/Self-Employed Division. The second wave of hiring is expected to come later this year, providing employees with promotional opportunities for higher-level enforcement positions, including in the Large Business & International, Small Business/Self-Employed and Tax-Exempt/Government Entities divisions, as well as positions in Appeals. Employees in the second wave of hiring will assist with high-profile enforcement areas, including international tax issues.

Despite the anticipated increase in hiring, Koskinen stated that, by the end of 2016, the I.R.S. will still be down more than 2,000 employees for the year, bringing the total loss of employees to over 17,000 since 2010. More than 5,000 of those lost employees have been in the enforcement areas. Thus, the addition of 600 to 700 employees in 2016 should be viewed not as an increase in hiring but simply as a decrease in attrition.

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