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Corporate Tax

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Overview of US corporate taxation 2012-2013

Over the past year, the major developments in US corporate tax law reflect growing efforts by the U.S. Internal Revenue Service (the "IRS") and the U.S. Treasury Department ("Treasury") to restrain tax-motivated transactions, both in domestic and cross-border contexts. Recent attempts by regulators to preserve the US tax base have cut back on some of the significant tax planning opportunities once available to US corporate tax practitioners and their clients, and renewed questions about the sustainability of current US corporate income tax rates, the US taxation of worldwide corporate income, and the design of the US tax system as a whole.

These perennial questions have become central public policy issues as the United States continues to face serious fiscal challenges, including mounting revenue demands driven by unprecedented budget deficits. At the same time, many other jurisdictions have embraced comprehensive corporate tax reform in recent years, causing increasing concern among large US corporations about their ability to succeed in a global marketplace as a result of perceived "anti-competitive" tax rules in the United States. Perhaps because of this unique confluence of circumstances, various proposals for sweeping tax reform in the United States appear to be gaining traction among policymakers.

Key developments in US corporate tax law

Under the US tax system, the provisions of the Internal Revenue Code are interpreted and supplemented by the IRS through regulations, rulings, notices, and other guidance. Consequently, in many situations, the IRS and Treasury will issue guidance with the intent of changing the behaviour of US corporate taxpayers, and the last year has been no exception. We will highlight significant guidance in the areas of corporate divisions and corporate inversions.

Expansion of IRS No-Rule Policy to certain tax-free corporate divisions under Section 355

On January 2, 2013, the IRS released Revenue Procedure 2013-3,[1] the annual list of areas in which the IRS will not issue private letter rulings or determination letters (the "2013 No-Rule List", or the "List"). If an issue appears on the List, it could suggest that the IRS is reconsidering its views on the issue, thereby limiting the ability of lawyers to render meaningful legal opinions on the issue. Without such an opinion, many large transactions involving public companies will not proceed.

Among the 2013 additions to the List were certain issues relating to tax-free corporate divisions under Section 355,[2] which may signal a coming shift in certain historically taxpayer-friendly positions of the IRS and Treasury with respect to these transactions.

Leveraged spin-offs under Section 355

In general, Section 355 permits a single corporation to be divided into two or more corporations on a tax-free basis when certain requirements are satisfied, on the theory that the division is merely a change in the form of an enterprise that continues to be owned by the same shareholders.[3] In preparation for a spin-off, the parent company may seek to extract value from the controlled subsidiary. If cash is distributed to the parent company, the cash is tax-free only to the extent of the parent company's tax basis in the controlled subsidiary; on the other hand, debt securities can be

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distributed tax-free without the same basis limitation.

Prior to the issuance of the 2013 No-Rule List, the IRS routinely approved in private rulings complex variations of the tax-free corporate division,[4] including a type of transaction referred to as a "leveraged spin-off". In the typical leveraged spin-off, the distributing corporation ("D") exchanges debt securities of the controlled corporation ("C") for the debt of D (a "debt-for-debt exchange"), tax-free and without regard to D's tax basis in C's assets. Where the liabilities of D that are "pushed down" into C exceed the tax basis of C's assets, D has been able to extract value from C in circumstances that would otherwise generally trigger the recognition of gain.

Recent incarnations of the debt-for-debt exchange transaction approved by the IRS involved financial intermediary facilitators pursuant to a "5-14" structure. D would issue new short-term debt to a financial intermediary, such as an investment bank, in exchange for cash. Five days after the issuance of the new debt by D, D and the bank would enter into a debt-for-debt exchange agreement. At least 14 days after the debt issuance by D, C would then distribute its securities to D, and D would use the newly-acquired securities of C to repurchase D's debt from the bank. The bank would then sell the securities of C in the market. As long as the taxpayer represented that D did not artificially increase its leverage in anticipation of the spin-off (usually by representing that the total amount of debt exchanged in the transaction did not exceed the average amount of D's debt outstanding in the previous year), the IRS consistently concluded in private rulings that an exchange would be tax-free, so long as the parties respected the five-day interval between the debt issuance and the entry into the exchange agreement, and the 14-day interval between the debt issuance and the debt repurchase.[5]

Practitioners disagreed about whether the taxpayer-favourable position of the IRS in the 5-14 rulings, and in similar rulings concerning corporate divisions, was consistent with fundamental tax principles that would generally indicate taxable exchange treatment for such transactions.[6] While some practitioners observed that leveraged spin-offs appeared to be purely tax-motivated, others countered that there are compelling policy reasons to permit flexibility in the structuring of corporate divisions.[7] Notwithstanding the concerns, the well-developed ruling practice of the IRS under Section 355 permitted US corporate tax practitioners to rely on leveraged spin-offs as a valuable tax planning tool.

The 2013 No-Rule List: implications for leveraged spin-off transactions

The 2013 No-Rule List announced that the IRS is studying the issue and, as a result, it will no longer issue rulings as to whether a debt-for-debt exchange in connection with a leveraged spin-off is tax-free where new debt of the distributing corporation is issued as part of the transaction.[8] This development does not necessarily mean that leveraged spin-offs within the scope of no-rule area, such as 5-14 transactions, will no longer be treated as tax-free under Section 355. However, an announcement that an issue is under study often signals that the IRS views corresponding transactions as problematic, and therefore reduces the level of certainty with which practitioners can advise their clients regarding such transactions. Some practitioners have already observed a chilling effect with respect to leveraged spin-off transactions since the List was released,[9] a trend that should be expected to continue until the IRS issues further guidance.

New anti-inversion regulations under Section 7874

In June 2012, Treasury and the IRS issued new temporary Treasury Regulations under Section 7874 that impose tighter restrictions on cross-border corporate inversions.[10] Treasury and IRS officials cited certainty and administrability as chief considerations in crafting the controversial new rules, which have been widely criticised by practitioners as a draconian and over-broad response to the perceived tax abuses associated with cross-border corporate inversions.[11]

Cross-border corporate inversion transactions

As shown in the chart overleaf, a cross-border corporate inversion is a transaction in which a US parent corporation of a multinational group is replaced by a new foreign parent corporation. Such transactions are frequently motivated by significant US tax benefits. By migrating ownership of non-US subsidiaries offshore, inversions seek to remove from US taxing jurisdiction the foreign income arising from the foreign operations of the group. In addition, inversions permit the introduction of

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leverage into the US group, often through the distribution of a note to the new foreign parent, which can meaningfully reduce the US tax liability on the earnings generated by the group's US operations.

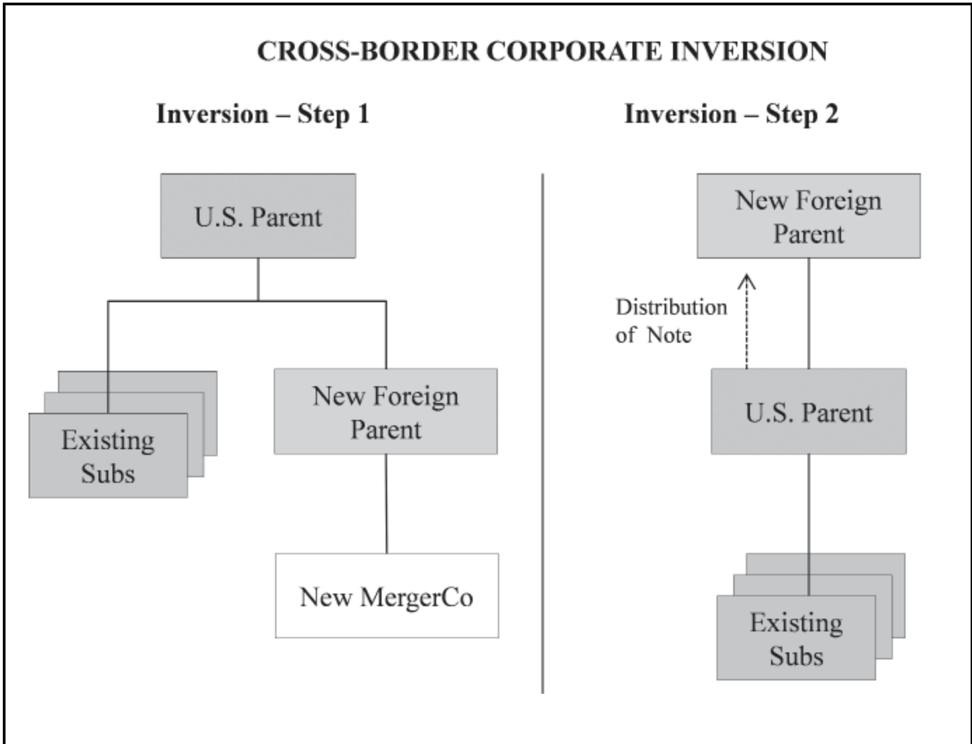

Table 1: Cross-border corporate inversion transactions

Section 7874 and the prior anti-inversion regulations

Congress enacted Section 7874 in 2004 to address perceived abuses associated with cross-border corporate inversions in which, without a significant change in the ownership of the multinational group, a US corporate parent was replaced with a non-US parent located in a low-tax jurisdiction with which the group had limited or no business nexus.[12] Subject to certain exceptions, Section 7874 generally provides that a foreign corporation that acquires a US corporation in a transaction in which the foreign corporation ends up owned 80% or more by the same shareholders will continue to be taxed as a US corporation unless the multinational group to which the corporations belong has "substantial business activities" in the new foreign parent's jurisdiction of incorporation.[13] In essence, Section 7874 deprives inverted multinational corporate groups of the tax benefits of expatriation by preserving US taxing jurisdiction over the entire corporate group when circumstances indicate that the expatriation was designed to avoid US taxation.

Temporary Treasury Regulations under Section 7874 issued in 2006 provided that the determination of whether a multinational group has substantial business activities in a jurisdiction is based on all the facts and circumstances.[14] The 2006 regulations also contained a substantial business activities safe harbour, which was generally satisfied if at least 10% of the multinational group's employees, assets and sales were located in or derived from the relevant foreign jurisdiction.[15] Temporary Treasury Regulations under Section 7874 issued in 2009 retained the facts and circumstances test for substantial business activities, but eliminated the safe harbour.[16] In response to Treasury's request for comments on the 2009 regulations, practitioners urged that future guidance reinstate some form of substantial business activities safe harbour, noting that there was considerable ambiguity regarding the proper application of the facts and circumstances test.[17] Despite this uncertainty, numerous highly publicised

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corporate inversions were effected under the 2009 regulations,[18] and more were being planned at the time the new temporary regulations were issued in 2012.[19]

The 2012 anti-inversion regulations

The 2012 regulations did away with the facts and circumstances test and adopted a new, bright-line test for determining whether a multinational corporate group has substantial business activities in the relevant foreign jurisdiction for purposes of Section 7874.[20] In general, the 2012 regulations provide that a multinational corporate group will have substantial business activities in the jurisdiction of the new foreign parent corporation *only if* at least 25% of the group's employees and assets are located in, and at least 25% of the group's income is derived from, that jurisdiction.[21]

The new bright-line threshold was a surprise for many practitioners. Prior to the issuance of the 2012 regulations, commentators had expected that any tightening of the substantial business activities test would come in the form of a safe harbour, similar to the one introduced in the 2006 regulations, but perhaps with more precisely-calculated inputs and moderately higher thresholds.[22] Although there was some debate among commentators about the appropriate design and scope of the modified safe harbour, it was widely assumed that future guidance would either retain the facts and circumstances test, or offer some other avenue for inverting corporate groups that did not satisfy the safe harbour, to avoid the harsh tax consequences of Section 7874 in non-abusive situations.[23]

The 2012 regulations created a starkly binary approach to the substantial business activities inquiry − an inverting multinational group either satisfies the 25% threshold discussed above, or the new foreign parent will be taxed as a US corporation under Section 7874 post-inversion. Practitioners have noted that this mechanical bifurcation is particularly unfair because the 25% threshold is so high.[24] Given the typical structure of a large transnational company, it is likely that most multinational corporate groups would not be able to satisfy the 25% threshold in any foreign jurisdiction, and even possibly in the United States.[25] For this reason, the prevailing view among US corporate tax practitioners is that the 2012 regulations effectively eliminated the substantial business activities exception to the application of Section 7874, and thereby asserted, in all but the rarest of cases, US taxing jurisdiction over any multinational groups that may effectuate inversions in the future.

The stated rationale for the bright-line test in the 2012 regulations was the twin interests of certainty and administrability.[26] However, it is unclear whether these interests justify the heavy-handed approach of the new rules. In the wake of criticism from the tax bar, officials have conceded that the strict, bright-line test was a reaction to the growing prevalence of cross-border corporate inversions under the 2009 regulations[27] and, presumably, the corresponding implications for the US tax base. The IRS reaction has been characterised as the US corporate tax equivalent of the Berlin Wall[28] and, at least so far, has had a comparable effect. At the time of writing, since the issuance of the 2012 regulations, the authors are not aware of any public announcements of new cross-border corporate inversions of US multinational corporations that rely on the "substantial business activities" exception of the 2012 regulations.

The future of cross-border corporate inversions: what lies beyond the bright-line?

The intermediate-term effects of the new rules remain unclear. Policy concerns, such as the perception of diminished global competitiveness of US-based multinational companies and the growing incentives to form new ventures offshore, may compel Treasury and the IRS to back away from the bright-line substantial business activities test in future guidance. But, for the time being, the 2012 regulations stand as a striking example of the recent efforts by Treasury and the IRS to curb tax-motivated transactions, and the success of the 2012 regulations in changing taxpayer behaviour, which may herald US corporate tax developments of a similar nature in the near future.

Case law developments

The heightened scrutiny of tax-motivated transactions by US tax regulators is also evidenced by the litigating positions of the IRS in recent tax controversies. In certain contexts, the courts have rewarded good tax planning with decisions favourable to taxpayers. This article focuses on decisions in *PepsiCo Puerto Rico Inc. v. Commissioner*[29] and *NA General Partnership v. Commissioner*[30] ("*ScottishPower*"), concerning the classification of an investment as debt or equity for US federal income tax purposes.

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The debt-equity distinction in general

The US corporate tax system provides strong incentives for companies to finance investments with debt rather than with equity. The general preference for debt over equity in the US corporate tax context stems from the fact that interest payments are deductible from corporate taxable income, whereas corporate dividend payments are not. As a result, corporate profits from debt-financed investments generally are taxed only to the extent they exceed corresponding interest payments, whereas profits from equity-financed investments are generally taxed at the 35% corporate rate. However, in some unique circumstances, a US corporate taxpayer may prefer to characterise an investment as equity rather than debt, as the discussion of *PepsiCo*, below, illustrates. Whether the ultimate preference is for debt or for equity, characterising a given investment for tax purposes as debt or equity is a fundamental consideration in US corporate taxation.

Despite the significance of the debt-equity distinction, the determination is hardly straightforward. Section 385 sets forth certain factors to be considered in determining whether an interest in a corporation is equity or debt, but the statute does not define these terms. Since 1983, when proposed regulations issued under Section 385 were withdrawn, relevant guidance has come primarily from the courts. In general, the determination of whether an investment is classified as debt or as equity for US federal income tax purposes relies on an analysis of a number of factors. Different courts use different tests, but the following factors are representative: (i) the label given to the investment by the parties; (ii) whether an investment has a fixed maturity date; (iii) the source of payments; (iv) whether there is a right to enforce payments; (v) participation in management by the putative creditor/shareholder as a result of the investment; (vi) subordination of the investment *vis-à-vis* corporate creditors; (vii) the intent of the parties; (viii) whether a creditor is also a shareholder; (ix) thin capitalisation of the entity into which the investment is made; (x) availability of credit on the same terms as any purported debt; (xi) use of the proceeds of the investment; (xii) repayment history; and (xiii) the degree of risk associated with the investment.[31]

PepsiCo

In *PepsiCo*, the Tax Court upheld the equity characterisation of a related-party investment by a US corporate taxpayer, PepsiCo Inc. ("PepsiCo"). Historically, PepsiCo had borrowed from its Netherlands Antilles finance subsidiary, and deducted the interest payments to the subsidiary from its US taxable income. In theory, the interest income at the level of the subsidiary could have been included in PepsiCo's taxable income under the CFC rules of subpart F.[32] However, the finance subsidiary owned interests in non-US PepsiCo operating companies with substantial losses, which offset the subsidiary's interest income and eliminated the possibility of subpart F income. At the time that this arrangement was put in place, the income tax treaty between the United States and the Netherlands extended the exemption from withholding tax for interest income under that treaty to residents of the Netherlands Antilles. Therefore, interest payments by PepsiCo to the finance subsidiary were not subject to US withholding tax, and the interest income of the finance subsidiary was not taxed to PepsiCo, yielding PepsiCo a net tax benefit in the United States.

When the extension of treaty benefits to residents of the Netherlands Antilles was later revoked, the interest payments by PepsiCo to the finance subsidiary would have been subject to US withholding tax. In response, PepsiCo designed an alternative structure that moved the PepsiCo notes from the Netherlands Antilles finance subsidiary to a new Dutch entity ("DutchCo") that qualified for benefits under the US Netherlands income tax treaty. Thus, interest payments from PepsiCo to DutchCo were not subject to US withholding tax. In order to avoid the imposition of tax on the interest income in the Netherlands, DutchCo needed to create an offsetting interest deduction. Accordingly, PepsiCo structured an investment it referred to as an "advance", pursuant to which a US affiliate of PepsiCo ("Affiliate") advanced funds to DutchCo and, in exchange, DutchCo made periodic payments to Affiliate. PepsiCo intended for the advance to be treated as a loan for Dutch tax purposes, so that the periodic payments to Affiliate would be treated as interest expense and would therefore be deductible against DutchCo's taxable income in the Netherlands. By contrast, PepsiCo intended for the advance to be characterised as an equity investment for US tax purposes, so that the periodic payments from DutchCo would be treated as tax-free return of capital

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to Affiliate.[33] The table below depicts the PepsiCo structure before and after the treaty revocation.

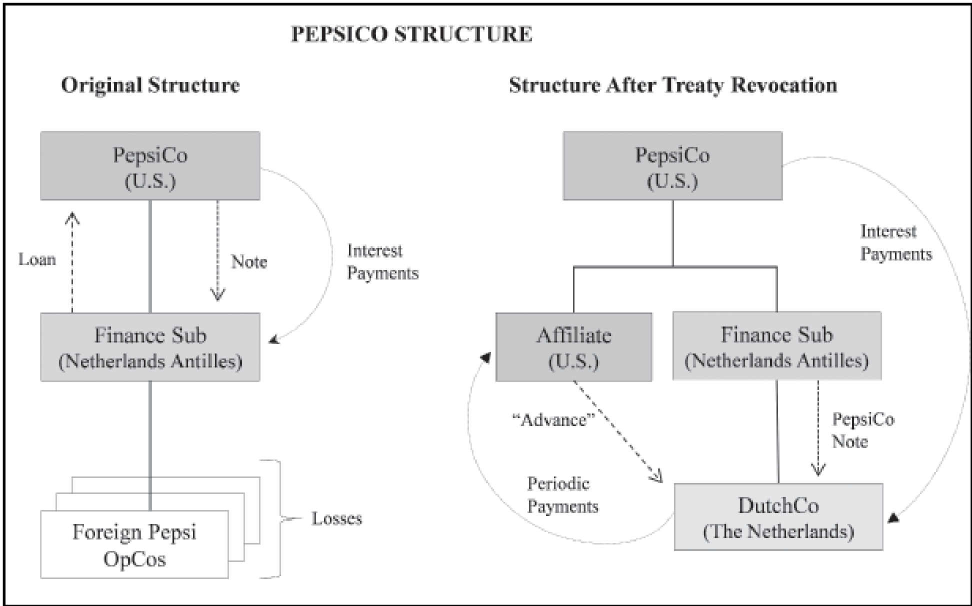

Table 2: PepsiCo structure before and after the treaty revocation

The IRS challenged the characterisation of the advance as equity for US federal income tax purposes, asserting that the advance was more properly characterised as debt and that the periodic payments were therefore interest income to Affiliate, not tax-free return of capital. This litigating position appeared to be motivated by discomfort with the asymmetrical treatment of the advance for US and Dutch tax purposes. Unpersuaded by the IRS's argument, the Tax Court decided for PepsiCo, respecting the characterisation of the advance as equity, and the periodic payments as tax-free return of capital, for US federal income tax purposes.

The *PepsiCo* decision is interesting in several respects. First, the court reaffirmed that the characterisation of an investment as debt, or as equity for US tax purposes, is not affected by the tax characterisation of the investment in another jurisdiction. US tax law permits an instrument to be characterised differently in the United States from a foreign country, and it is permissible for taxpayers to exploit such asymmetries for tax planning purposes. Second, in its analysis of the debt-equity factors, the court placed significant emphasis on the legal obligations created by the terms of the advance agreement between PepsiCo and DutchCo. The court accepted the terms of the advance as written notwithstanding the fact that PepsiCo exercised control over DutchCo, and such terms could thus change over time. Third, PepsiCo's careful tax planning worked to its advantage in the case. The court concluded that the transaction, although carefully structured to generate tax benefits, should be respected, as it was designed to respond to a change in treaty law, and was not marketed by a tax-shelter promoter.

ScottishPower

In *ScottishPower*, a UK company, ScottishPower, sought to acquire a US-based utility company, PacifiCorp, using stock of ScottishPower. ScottishPower formed NA General Partnership ("NAGP"), a Nevada partnership, but elected to treat it as a corporation for US federal income tax purposes. ScottishPower transferred 25% of the shares necessary to acquire PacifiCorp to NAGP in exchange for shares of NAGP, and transferred the remaining 75% of the necessary shares to NAGP in exchange for loan notes issued by NAGP. In total, NAGP issued approximately $5bn in loan notes to ScottishPower. NAGP formed a subsidiary corporation, which merged into PacifiCorp, whereupon the common stock of PacifiCorp was cancelled and converted into the right to receive ScottishPower shares. NAGP then

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transferred the shares of ScottishPower that it had acquired to the former PacifiCorp shareholders.

During the years under examination, NAGP paid some of the interest on the notes using dividends from PacifiCorp. When NAGP was temporarily unable to receive dividends from PacifiCorp, NAGP borrowed funds from an unrelated third party, as well as ScottishPower, to pay interest on the notes to ScottishPower. ScottishPower later decided to capitalise approximately $2.5bn of the NAGP debt to equity, partially in response to the issuance of proposed Treasury Regulations that would have recharacterised NAGP's interest payments to ScottishPower as nondeductible dividends. The table below depicts the basic ScottishPower investment structure.

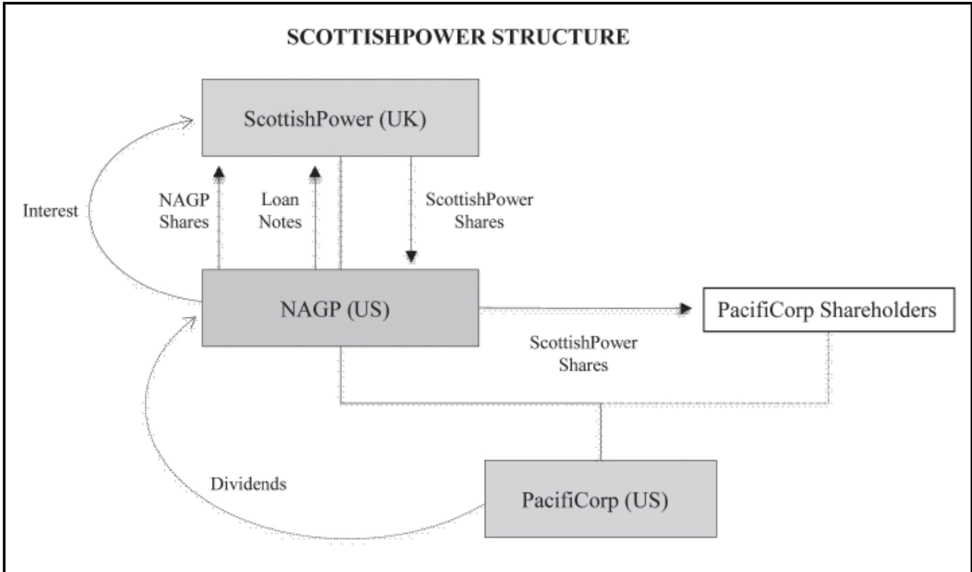

Table 3: The ScottishPower investment structure

The IRS challenged the ScottishPower structure on the grounds that the stock advance that ScottishPower made to NAGP in exchange for NAGP loan notes was not debt, but was a capital contribution to NAGP for US federal tax purposes. Thus, payments by NAGP to ScottishPower were either dividends or return of capital, rather than deductible interest. The Tax Court rejected the IRS's argument and held for NAGP, concluding that the advance of shares to NAGP was a loan, and the payments to ScottishPower were deductible interest payments.

Several elements of the *ScottishPower* decision are worthy of comment. First, the Tax Court did not object to ScottishPower's arbitrage of the check-the-box rules − ScottishPower caused NAGP to be treated as a corporation for US federal income tax purposes, even though ScottishPower treated NAGP as a partnership in the UK to derive UK tax benefits. Second, the court was not troubled by the inability of NAGP to receive dividends from PacifiCorp during a portion of the loan term, even though dividends were the sole source of payments for the loan other than additional borrowings. Third, the court did not take issue with the later capitalisation of roughly half of the NAGP debt to equity, citing changed legal circumstances as a legitimate purpose for the recapitalisation. Fourth, the court confirmed that structural subordination of a debt (i.e., a loan to a holding company) is not as concerning as subordination to a borrower's other creditors. Finally, the court appeared to reach its conclusion for the taxpayer based in large part on the fact that the parties took the debt seriously by making regular interest payments and by generating pro formas and projections, showing an ability to service the debt at regular intervals.

Debt-equity case law developments: implications

In contrast to *PepsiCo* and *ScottishPower*, notable corporate taxpayer losses have occurred in other recent debt-equity cases.[34] However, the decisions in *PepsiCo* and *ScottishPower* are significant

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for at least four reasons. First, the decisions reinforce the current approach of the Tax Court to the debt-equity analysis in the corporate context. Second, the decisions suggest that the court's approach remains grounded in well-established principles, i.e., the debt-equity factors developed in case law, at a time when the IRS has aggressively challenged related-party financing structures, often with theories that test the boundaries of legal precedent. Third, although debt-equity determinations are characteristically fact-driven, the decisions suggest transaction characteristics that may shape future corporate tax planning techniques in the cross-border context. Finally, corporate tax practitioners and their clients should derive some encouragement from *PepsiCo* and *ScottishPower,* because both decisions rewarded taxpayers who had received substantial tax benefits from complex tax-driven investment structures.[35] As Treasury and the IRS continue administrative efforts to restrain tax-motivated transactions, taxpayer victories may be increasingly confined to the courts.

Current US corporate tax reform proposals

Tax reform is a perennial issue for policymakers in the United States. However, the current fiscal landscape has energised public debate about the proper priorities of a tax system, and the best methods to achieve them. The concerns of key stakeholders are difficult to reconcile − revenue needs, economic competitiveness, simplicity, administrability, and fairness are just a few of the competing concerns that any tax reform proposal must balance. We highlight some of the significant recent proposals below.

Chairman Camp's international tax reform discussion draft

In October 2011, U.S. House of Representatives Ways and Means Committee Chairman Dave Camp released a discussion draft of an international tax reform proposal[36] that has received considerable attention from policymakers, practitioners, and commentators. Currently, the United States taxes US corporations on their worldwide income, regardless of whether that income is earned in the United States or in another jurisdiction − a system that is referred to as worldwide taxation, or taxation based on nationality. Camp's proposal would have the United States move away from a system of worldwide taxation to a territorial system, in which the United States generally would only tax US corporate income that is earned in the United States. Because most countries have territorial systems, and generally have lower corporate income tax rates than the United States, some commentators view the switch to a territorial system as a way to enhance the competitiveness of US-based multinational companies and reduce incentives to engage in tax-motivated transactions, like some of the transactions discussed above.

The proposal would accomplish the transition to a territorial system by: (i) reducing the US corporate tax rate from 35% to 25%; (ii) creating a dividend exemption whereby US corporations would be entitled to a 95% dividends-received deduction with respect to dividends from non-US subsidiaries; (iii) simplifying the current US foreign tax credit regime;[37] (iv) instituting new measures to protect the US tax base, which would subject certain types of foreign income to full US taxation on a current basis; and (v) implementing an interest deduction limitation that would limit interest expense deductions for US corporations based on capital structure and interest expense in proportion to taxable income. As a one-time cost of transitioning to this system, all previously untaxed offshore earnings would be treated as repatriated and subject to a one-time tax.

Some commentators believe that reform of the US income tax alone will be insufficient to address growing US revenue needs and concerns about economic competitiveness, and have suggested supplementing the US income tax with a VAT and/or a carbon tax.[38] Imposing a VAT, for example, would align the US tax system more with international norms, and the revenue generated by a VAT would also permit a reduction in the rate of the corporate income tax. However, it may be overly optimistic to expect to accomplish comprehensive tax reform in light of the political deadlock that has virtually paralysed the U.S. Congress in recent years.[39]

Conclusion

Although proponents of US tax reform have been gaining momentum in recent months, significant barriers to a comprehensive overhaul of the US tax system remain, and are not likely to be overcome

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in the near future. Given budgetary constraints and a Democratic administration, administrative guidance will likely continue to address tax-motivated transactions. Although outcomes in the courts are difficult to predict, the aggressive posture of Treasury and the IRS with respect to tax-driven structures, coupled with enhanced information reporting, will continue to trigger an upsurge in tax litigation.

* * *

Endnotes

1. 2013-1 I.R.B. 113.
2. Unless otherwise noted, all Section references are to the Internal Revenue Code of 1986, as amended (the "Code").
3. *See* I.R.C. § 355.
4. *See, e.g.*, I.R.S. P.L.R.s 201232014 (Aug. 10, 2012), 200837027 (Sept. 12, 2008), 200624001 (June 16, 2006).
5. *See* I.R.S. P.L.R.s 201232014 (Aug. 10, 2012), 201132009 (Aug. 12, 2011), 201129005 (July 22, 2011), 201032017 (Aug. 13, 2010), 200802009 (Jan. 11, 2008).
6. *See* Amy S. Elliott, *Practitioners Consider How Current Code Distorts Leveraged Spinoff Decisions*, 2012 Tax Notes Today 220-5 (2012).
7. *See id.*
8. *See* Rev. Rul. 2013-3, 2013-1 I.R.B. 113.
9. *See* Amy S. Elliott, *ABA Meeting: Practitioners Parse Implications of Expanded Corporate No-Rule Policy*, 2013 Tax Notes Today 19-1 (2013).
10. *See* T.D. 9592, 2012-28 I.R.B. 41; Temp. Treas. Reg. § 1.7874-3T.
11. *See* Jeremiah Coder, *Irrebuttable Rule in New Substantial Business Activity Test Is Excessive, Practitioners Say*, 2012 Tax Notes Today 112-4 (2012).
12. *See* H.R. Rep. No. 108-755 at 568 (2004) (Conf. Rep.); Joint Comm. on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress*, 342 (2005).
13. *See* I.R.C. § 7874.
14. *See* T.D. 9265, 2006-2 C.B. 1.
15. *See id.*
16. *See* T.D. 9453, 2009-28 I.R.B. 114.
17. *See, e.g.*, N.Y. State Bar Ass'n Tax Section, *Report on Certain Issues Under Section 7874, Rep. No. 1211* (2010).
18. E.g., Ensco (2009); Aon (2012); and Rowan (2012).
19. *See* Coder, *supra* note 11.
20. *See* Temp. Treas. Reg. § 1.7874-3T.
21. *See id*.
22. *See, e.g.*, N.Y. State Bar Ass'n Tax Section, *supra* note 17; Coder, *supra* note 11.
23. *See* N.Y. State Bar Ass'n Tax Section, *supra* note 17.
24. *See* Coder, *supra* note 11.
25. *See id.* One example of a transaction that would likely still satisfy the 2012 regulations is the 2009 inversion of Tim Hortons Inc., a company with numerous coffee and donuts shops in the United States and Canada. In 2009, Tim Hortons Inc. inverted from a US parent corporation into a Canadian parent company.
26. *See* T.D. 9592, 2012-28 I.R.B. 41.
27. *See* Coder, *supra* note 11.
28. The authors would like to thank their colleague, Arthur D. Pasternak, for this vivid comparison.
29. T.C. Memo 2012-269 (2012).
30. T.C. Memo 2012-172 (2012).
31. *See generally* L. Howard Adams, *What Role for Equity in Applying Factors for Distinguishing Debt?*, 2013 Tax Notes Today 43-8 (2013) (discussing the multifactor debt-equity tests in various jurisdictions).

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32. In general, subpart F of the Code requires US shareholders to include in taxable income on a current basis their pro-rata share of a foreign corporation's subpart F income, regardless of whether that income has been distributed to the shareholder, where the foreign corporation is a controlled foreign corporation ("CFC") i.e., US persons each owning ten percent of the stock together own 50 per cent or more of the foreign corporation's stock (measured by vote or value). Subpart F income consists of various types of income that are typically quite mobile and often subject to low rates of foreign tax, for example, dividend and interest income. *See* I.R.C. §§ 951-965.
33. The payments would be treated as a return of capital to Affiliate rather than as dividends because DutchCo would not have earnings and profits.
34. *See, e.g., Hewlett-Packard Co. v. Commissioner*, T.C. Memo 2012-135 (2012). In *Hewlett-Packard*, Judge Goeke, who also decided *PepsiCo*, held that a taxpayer's purported equity investment in preferred stock of an unrelated Dutch corporation, in a transaction designed to generate excess foreign tax credits, was properly characterised as debt for US federal income tax purposes.
35. Not all taxpayers have been rewarded for implementing complex tax-driven structures in recent tax controversies. For example, in *Consolidated Edison Co. of New York Inc. v. United States*, No. 2012-5040, 2013 TNT 7-10 (Fed. Cir. Jan. 9, 2013), the Federal Circuit reversed a lower court to disallow a US corporation the tax benefits of a complicated tax-driven structure. ConEd had acquired a Dutch energy facility using a lease-in lease-out structure, variations of which the IRS later described as "listed" transactions requiring special disclosure. Rev. Rul. 2002-69, 2002-2 C.B. 760.
36. Camp's discussion draft can be found at the Ways and Means Committee website: http://waysandmeans.house.gov/taxreform.
37. The US foreign tax credit regime, which allows taxpayers a credit against US tax liability for foreign taxes paid under certain circumstances, is notoriously complex.
38. *See* Meg Shreve, *Panelists Urge Congress to Seek Alternative to Income Tax*, 2013 Tax Notes Today 37-4 (2013).
39. *Id.*

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