

The Plays Within The Play



Roger D Wheeler

Chief Tax Officer – General Motors

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Electronic Presentation Copy

The Plays Within the Play

Cast of Characters

US

US Parent company

C

Canadian subsidiary

A

Australian subsidiary

K

Korean Target Co.

K

Korean subsidiary

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The Stage



US

C

A

K

K

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Act One – The Funding

- Canadian sub subscribes to US\$100 of Australian sub in form of \$A denominated RPS shares
- Canadian sub borrows US\$50 (C\$75) from a bank to fund ½ of RPS purchase
- Canadian sub sets aside US\$ 50 (C\$75) of current earnings to fund ½ of RPS purchase
- Canadian sub purchases \$A-denominated RPS for US\$100
- US parent owns 100% of both Canadian and Australian sub, in form of ordinary shares

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Act Two – The Acquisition of Target

- Australian sub establishes a newly-formed Korean sub and purchases 45% of its ordinary shares for \$US100
- The remaining 55% of Korean sub is funded and owned by third parties
- Korean sub purchases selected assets from Korean target co
- Selected assets include Korean factories and equipment, plus European subsidiaries of Korean target co
- An option to buy an additional factory is also included

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Act Three – The Repatriations

- Australian sub pays dividend on RPS to Canadian sub
- Canadian sub receives the RPS dividend, net of withholding tax
- Canadian sub pays interest on bank borrowing
- Canadian sub reduced regular dividend to US parent
- US parent receives the reduced regular dividend, net of withholding tax

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A Taxwise Synopsis of the Play

- Canadian sub tax deducts interest on borrowings
- Canadian sub remits less withholding tax on reduced dividend to US parent
- Canadian sub avoids income tax on RPS dividend received
- Australian sub tax deducts RPS dividend paid
- US parent acquires Korean target business with “other people’s money”
- US parent reduces US tax on Canadian earnings
- Korean sub avoids existing liabilities of Korean target co

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The Canadian Play Within

- Are the RPS shares debt or equity under Canadian commercial law?
- Is any portion of the RPS dividend taxable?
 - How much of the RPS dividends is paid out of “active business income” (exempt surplus)?
 - How do you calculate “exempt surplus”? Trick question
- Does any passive income attach to the RPS? FAPI Question
 - Are RPS acquired by Canadian sub in “ordinary course” of its business? Another trick question
- Watch for the capital gain/loss mismatch on hedged currency.
- Is this transaction subject to GAAR?

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The Australian Play Within

- Are the RPS shares debt or equity under Australian tax law?
- Is it preferable for Australian sub to tax deduct the pay out at 30% or avoid a 10% withholding tax?
 - Does the RPS pay out come from “retained profits”?
 - How do you calculate “retained profits”?
 - Is the RPS dividend “arm’s-length” under Australian law?
- Do any Australian anti-abuse rules apply?
 - Are there any Australian GAAR issues?
 - What is the “dominant purpose” of the transaction?

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The US Play Within

- Has Canadian sub in effect paid a “dividend” to US parent, resulting in “imputed” US taxable income?
- Does the RPS dividend give rise to US subpart F income –
 - does it matter whether RPS income is a “dividend” or “interest” to Canadian sub?
- Is this transaction or series of transactions a US “tax shelter” – a “listed transaction” or “similar”?

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The Korean Play Within

- By purchasing assets, Korean sub avoids existing liabilities of Korean target, but ...
- By buying shares of target co's European subs, their existing liabilities continue
- Does either of the third-party investors own 30%+ of Korean sub?
- Despite ownership percentages, are these parties dealing at arm's-length or not?
- Are there any tax exemptions for the asset transfer?
 - If, so what about a later purchase of an additional plant now under option
- Is the stipulated option price based on Fair Market Value?

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The Non-Tax Plays Within

- But if I own the Korean sub, won't its operating losses be included in my Australian financial results?
- And why should I help facilitate acquisition of a foreign business which will one day become an importer of product directly in competition to mine?
- Why should I, the Canadian sub, fund a business being acquired for my US parent; doesn't that adversely affect my financial results? And ...

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The Non-Tax Plays Within

- Why can't I hire the same CPA firm to perform due diligence, provide me with tax planning and compliance, and then audit my financial results?
- I don't like all this complexity; simply pay a big Canadian dividend and let me just buy the Korean target co
- Don't bother me ... I've got labor relations problems
- Don't bother me ... I'm going bankrupt!