

# The 13th Annual Americas School of Mines Mergers and Acquisitions

Kirsten Nordlof  
Director, Mergers and Acquisitions

## Agenda/Contents

1. Introduction / Recent Mining M&A Activity (10 minutes)
2. Mining Specific U.S. Tax Due Diligence Issues (10 minutes)
3. Change of Control Issues (35 minutes)
4. Discussion of the Santa Fe Case (White Knight fee deductibility) (5 minutes)
5. Recent Law Changes / Proposals (not industry specific – 20 minutes)
6. Questions (10 minutes)

## Section

- 1. Introduction / Recent Mining M&A Activity (10 minutes)**
2. Mining Specific U.S. Tax Due Diligence Issues (10 minutes)
3. Change of Control Issues (35 minutes)
4. Discussion of the Santa Fe Case (White Knight fee deductibility) (5 minutes)
5. Recent Law Changes / Proposals (not industry specific – 20 minutes)
6. Questions (10 minutes)

## Speaker:

Kirsten Nordlof is a director in the Mergers and Acquisitions (M&A) practice in San Francisco. As a tax M&A advisor, Kirsten has 9 years of experience working with private equity firms and multinational corporations in all stages of the deal cycle, including conducting tax due diligence, tax structuring and post-acquisition integration. In addition to working in the San Francisco M&A practice, Kirsten spent 3 years in PwC's Washington National Tax Services (WNTS) M&A practice in Washington DC.

Phone: 415.498.5026

Email: [kirsten.m.nordlof@us.pwc.com](mailto:kirsten.m.nordlof@us.pwc.com)

## Recent Mining M&A Activity

- Low activity in smaller deals (value under \$100 million) in the first quarter of 2009 – lowest since 2006; rebounded in second quarter (Dealogic)
- Value of proposed takeovers in mining sector soared to \$122.1 Billion in second quarter of 2009 (Dealogic)
- Deals may be picking up as share prices rise, making share deals more sustainable
- With credit markets tight, projects may be looking for cash for operations (i.e., Boasteel investing Aus \$285 million into Aquila Resources, announced at the end of August)

## Section

1. Introduction / Recent Mining M&A Activity (10 minutes)
2. **Mining Specific U.S. Tax Due Diligence Issues (10 minutes)**
3. Change of Control Issues (35 minutes)
4. Discussion of the Santa Fe Case (White Knight fee deductibility) (5 minutes)
5. Recent Law Changes / Proposals (not industry specific – 20 minutes)
6. Questions (10 minutes)

## First its important to understand the “why”

- Looking for items that will impact the purchase price, such as latent tax liabilities
- Looking for items to receive indemnification against, such as contingent historic liabilities
- Looking for items that will impact the model (changes in tax rate, recapture of historic items, end of life of amortizable/depreciable property)
- Looking for items that you want to correct going forward (tax function, withholding practices, elections that need to be made, transfer pricing, etc.)

## Next its important to understand the “what”

- Looking for items that will impact the purchase price, such as latent tax liabilities
- Negotiate reductions in purchase price, quantify liabilities, access risk
- Looking for items to receive indemnification against, such as contingent historic liabilities
- Review purchase agreement representation and warranty sections, review indemnification provisions. Ensure seller has ability to indemnify or ask for escrow
- Looking for items that will impact the financial model
- Review financial model for tax rate, adjust for diligence items found
- Looking for items that you want to correct going forward
- Document advice and tentative plan of steps for correction. Information often gets lost in the hustle of the deal

## Now a list of some of the things you should be looking for....

- Recapture Issues (exploration costs)
  - Historic liability and/or financial modeling issue
- Treatment of Exploration (expense but may elect to capitalize) and Development Expenses (capitalized but may elect to expense).
  - Historic liability or financial modeling issue
  - Understand for tax function (elections may be treated as method of accounting and difficult to change)
- Accounting Methods
  - Depreciation methods / depreciation periods - Understand for tax function going forward
  - Look for wrong periods – historic liability
  - Allow / allowable issue – potential cures for past issues
- Tax Treatment of Environmental Liabilities (section 198)
  - Historic liability or financial modeling
- Obsolete Equipment
  - Timing of deduction. Date of worthlessness.
  - Historic liability, financial modeling and/or tax function

## Now a list of some of the things you should be looking for....

- Tax Treatment of Performance Based Agreements (royalty agreements)
  - Understand all agreements – tax function and historic liability (in relation to depletion)
- Aggregation of Mines
  - Elections to aggregate or disaggregate mining leases
  - Have they been treating a parcel as a single mine without election?
  - This can impact historic liabilities, financial modeling and/or tax function
- Abandonment of Sites
  - Review paperwork to understand historic deductions for abandonment
  - Need to have actually abandoned to get deduction
- Reclamation Elections / liabilities
  - Review historic elections and liabilities to understand company's position
- FIRPTA
  - Historic transactions, compliance and reporting and impact of current transaction

Keep this list growing – add ideas that come to mind now  
Issues that come up in your own deals....

- withholding certificates

## Section

1. Introduction / Recent Mining M&A Activity (10 minutes)
2. Mining Specific U.S. Tax Due Diligence Issues (10 minutes)
3. **Change of Control Issues (35 minutes)**
4. Discussion of the Santa Fe Case (White Knight fee deductibility) (5 minutes)
5. Recent Law Changes / Proposals (not industry specific – 20 minutes)
6. Questions (10 minutes)

## Topics we will cover in this section

In this section we will cover:

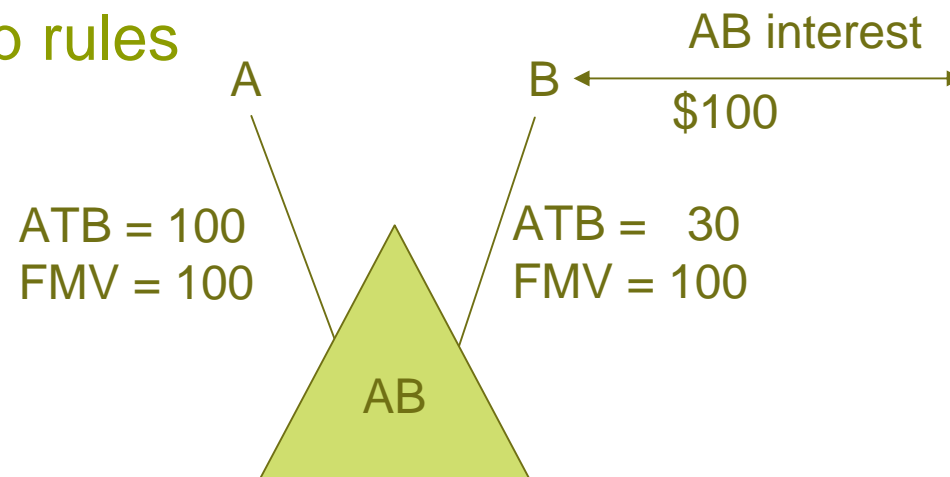
- Partnership Issues
  - Section 743 / 754 Adjustments
  - Partnership Terminations
- Corporate Issues
  - Loss limitations
  - Built-in Losses and Gains

## Section 754 Elections

- Entity-aggregate theory demands that a partner's basis in its partnership interest equal its share of the partnership's basis in its assets.
- However, this equality can be thrown off by the following:
  - Sale of a partnership interest
  - Distribution of cash in excess of basis
  - Distribution of property with different tax basis
- To cure disparities, Section 754 allows partnership to adjust the inside basis of partnership property

## Section 754 Election

- Inside and Outside basis differentials are created under the partnership rules



- Basis adjustments were created to cure differentials
  - § 734(b) Adjustment – adjustments on distribution
  - § 743(b) Adjustment – transfers by sale or exchange

## Section 754 Election (continue)

- Partnership rules try to keep outside and inside basis equal to prevent duplication of gains and losses.
- Sale of a partnership interest may create inequality.
- Optional 754 election allows purchaser to equalize outside and inside basis.

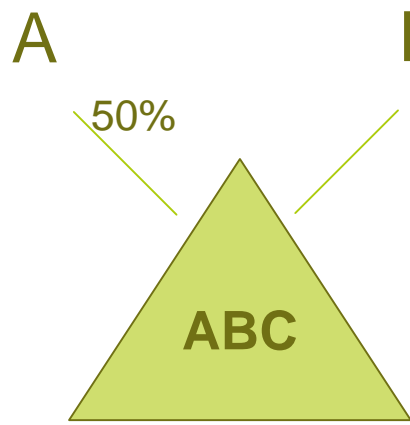
## Section 743(b) Adjustment

§ 743(b) allows basis of partnership property to be adjusted to reflect transferee partner's outside basis

Adjustment with regard to transferee partner only

If relates to depreciable asset then treat as new asset

## Section 743(b) Basis Adjustment-Example (continued)



	<u>FMV</u>	<u>ATB</u>	<u>BIG</u>
<b>A</b> Inventory	100	50	50
<b>B</b> Building	<u>100</u>	<u>80</u>	<u>20</u>
Total Assets	$200/2 = 100$	$130/2 = 65$	$70/2 = 35$
Capital A	100	65	
Capital B	<u>100</u>	<u>65</u>	
Total Liabilities & Capital	200	130	

- A recognizes gain of \$35
- Without a § 743(b) basis adjustment, C's outside basis would be \$100 (the amount paid) and C's inside basis would be \$65.
- If ABC sold its assets, \$35 of gain would be allocated to C
- \$35 of gain would be taxed twice

## Computation of § 743(b) Adjustment (cont'd)

C's Outside Basis =	\$100 =	\$100 Paid + \$0 Liabilities
- <u>C's Inside Basis</u> =	\$65 =	Previously Taxed Capital + Liabilities
		\$65                      \$0
= § 743(b) Adjustment	\$35	

Previously Taxed Capital	=	\$100 Cash on Liquidation*
		- \$35 Buyer's Gain on Liquidation
		+ Buyer's Loss on Liquidation

## Allocation of the Basis Adjustment

### Section 755

- The allocation of the basis adjustment generally reduces the difference between the FMV and basis of each asset adjusted
- Two-way basis adjustments permitted

## Allocation of § 743(b) Basis Adjustment (continued)

- Separate the partnership property into capital/1231 and ordinary classes
- Allocate basis adjustment between and among classes using a hypothetical sale approach
- Allocate the basis adjustment first, to the ordinary income class, and the excess to the capital asset class
- Adjustments within a class determined by hypothetical sale approach

Example:	C's share of gain in Inventory	\$25 (\$50 x 50%)
	C's share of gain in Building	<u>\$10</u> (\$20 x 50%)
	C's § 743(b) basis adjustment	\$35

## 4 Ways a Partnership Can Terminate

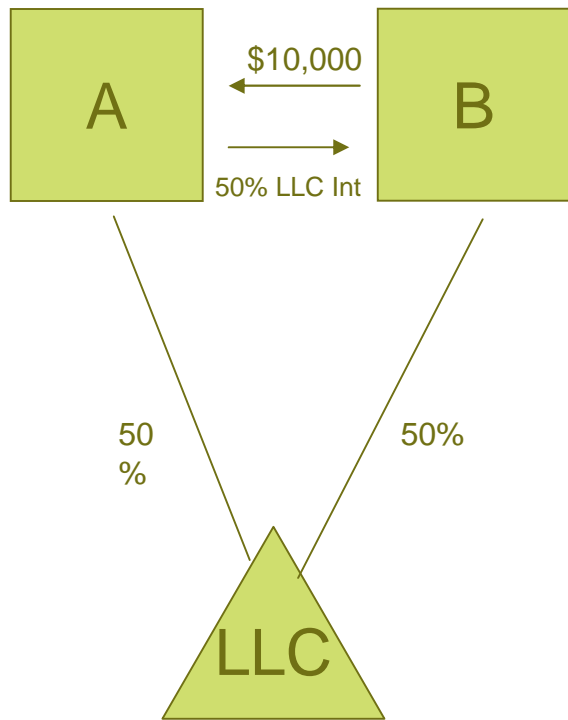
- § 708(b)(1)(A) (termination)
- § 708(b)(1)(B) (tech termination)
- Merger / Conversion
- Division

## Partnership Terminations

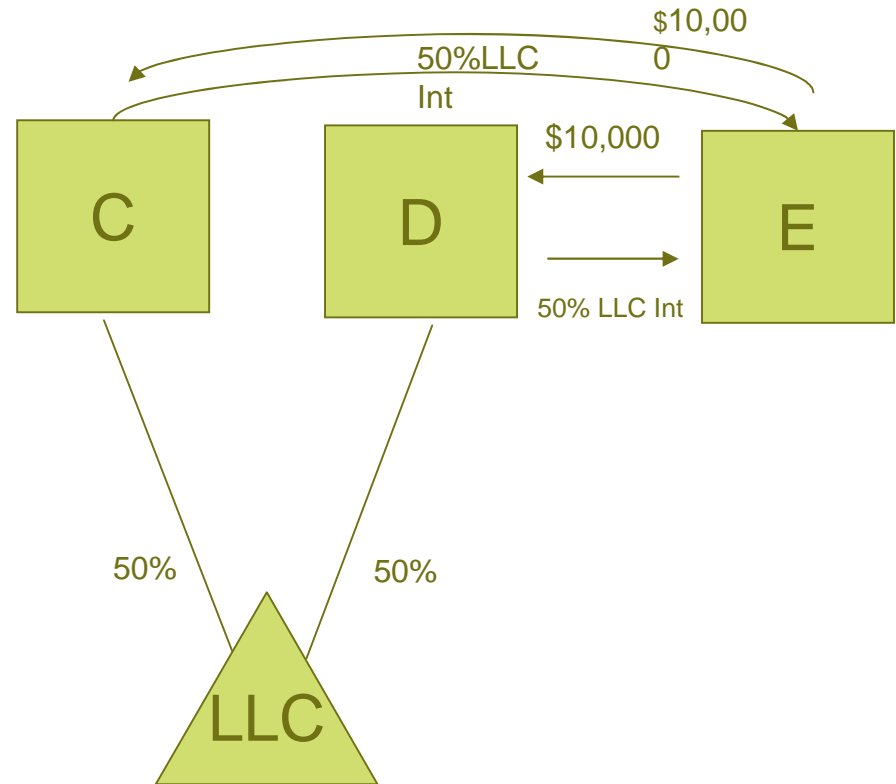
- §708(b)(1)(A): No part of any business, financial operation or venture of partnership continues to be carried on by the partners
- One partner buys second partner's interest: Rev. Rul. 99-6
  - Bifurcated treatment
    - Sale of capital asset
    - Liquidation & asset purchase
- Cessation of Business Activities
  - Liquidation under State Law
  - Winding up period

# Rev. Rul. 99-6: § 708(b)(1)(A) Termination

## Scenario 1



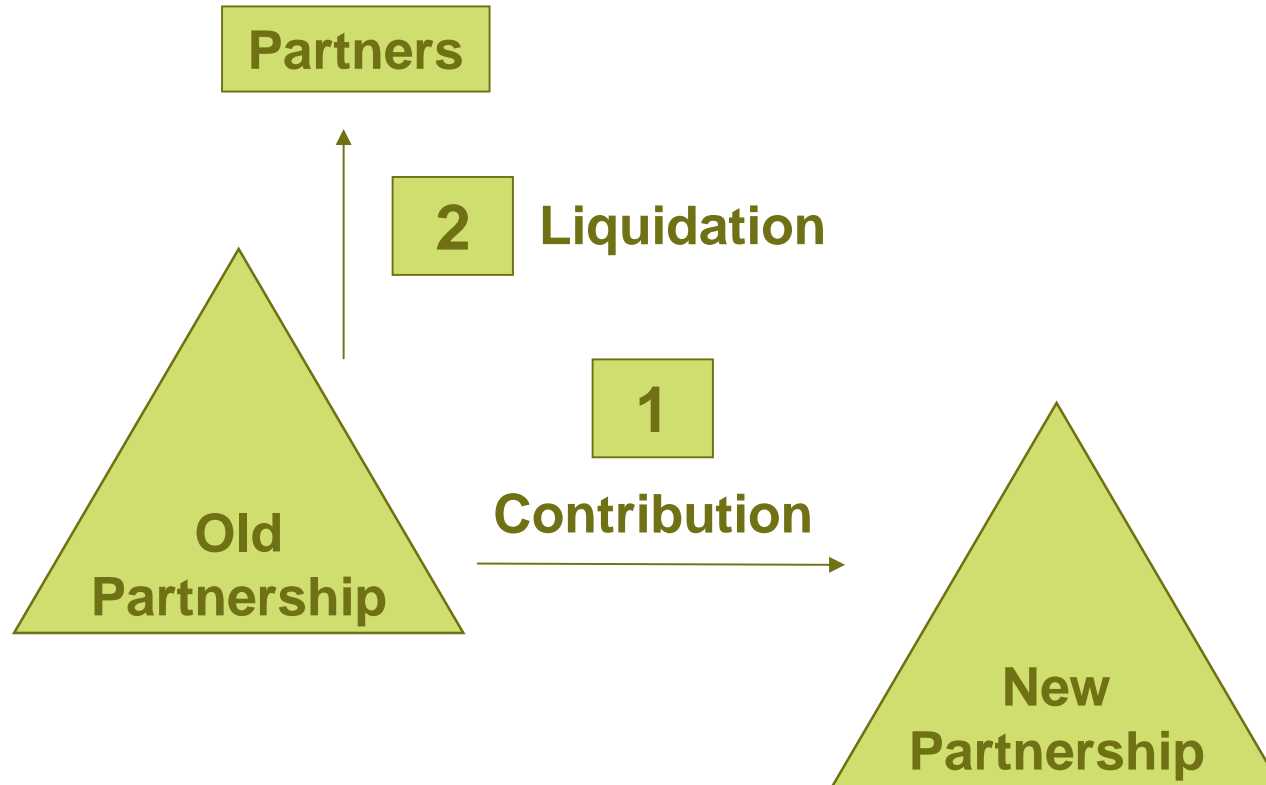
## Scenario 2



## Section 708(b)(1)(B)

- §708(b)(1)(B): Sale or exchange of  $\geq 50\%$  capital and profits within a 12-month period
  - Technical Termination
  - Short Year Return

## Form of Technical Termination



## Partnership Terminations

### What is a “Sale or Exchange”

- Contribution of Partnership Interest to a Corporation
- Corporate or partnership distribution of partnership interests
- A § 368 reorganization (except ‘B’ or ‘F’)
- Contribution of a partnership interest to another partnership
- Sale or exchange of an interest in a lower-tier partnership if the upper-tier terminates
- Liquidation of a corporate partner

## Partnership Terminations

### What is not “Sale or Exchange”

- “Sale or Exchange” does NOT include:
  - Contributions to partnership for new interest
  - Liquidations of interests
  - Sales of the same interest within 12 months
  - Gifts, inheritances, or bequests
  - Partnership to partnership conversions
  - For a lower-tier partnership, the sale of an interest in the upper-tier partnership if the sale does not cause the termination of the upper-tier partnership

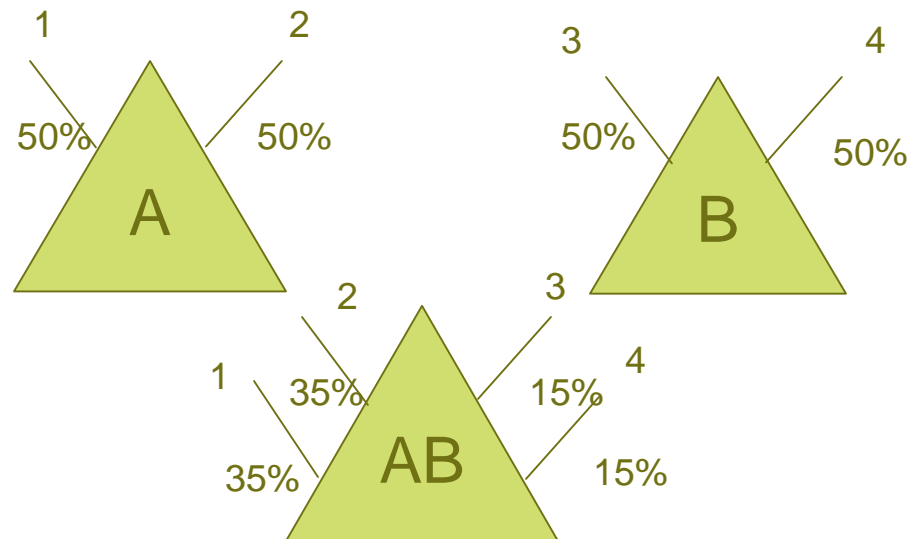
## Consequences of § 708(b)(1)(B) Terminations

- Restart depreciation
  - but, § 197 assets are not ‘newly acquired’
- Closing of the Partnership Tax Year
  - Short Year Return – end on date of termination
  - Due date 3.5 months after date of termination
- Elections (but not new EIN)
  - § 754 Election of old will apply to purchaser for old partnership
  - New Partnership must make all new elections including § 754, inventory methods, § 179 expensing of business assets
- Basis Rules
  - Capital Accounts carry over
  - Holding period will “tack”
    - Except: interest received for non-capital assets (Sec. 1223(1))

## Mergers

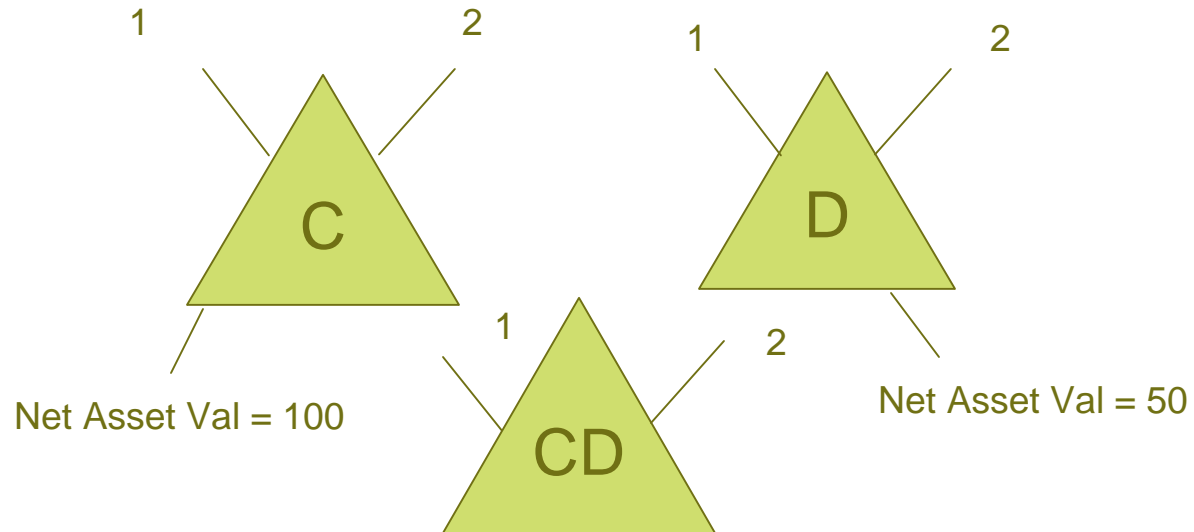
- Merger: The resulting partnership, for § 708 purposes, is treated as a continuation of the merging partnership whose members own more than 50% of the resulting partnership
  - If members of both merging partnerships own more than 50%, the resulting partnership treated as continuation of merging partnership with greater net asset value.

## Partnership Mergers Treas. Reg. §1.708-1(c)



- A and B merge into AB
- A continues
- B terminates

## Partnership Mergers Treas. Reg. §1.708-1(c)



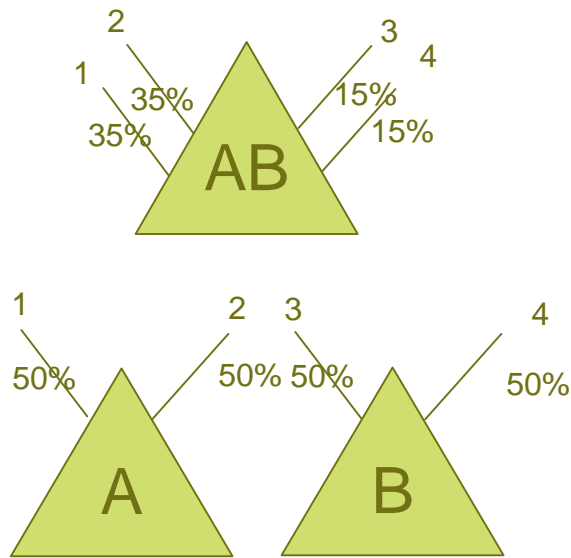
- C and D merge into CD
- FMV of C's net assets exceed D's
- D terminates
- C continues

## Divisions

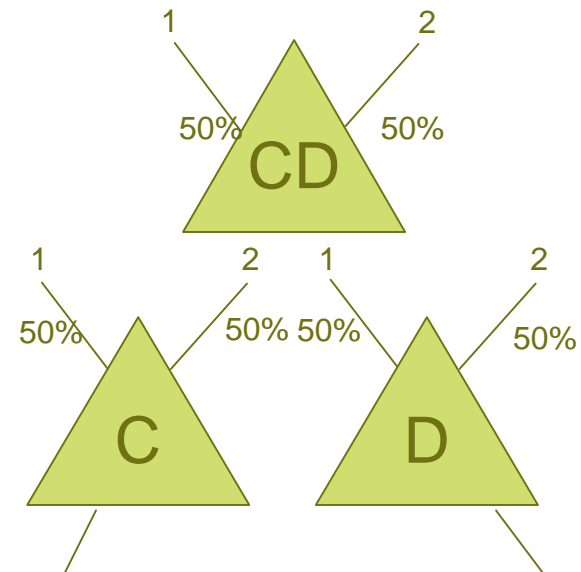
- Division: The resulting partnership whose members had a greater than 50% ownership of the original partnership is considered a continuation of the original partnership
  - If 50% owners become owners in both resulting partnerships, partnership resulting with greater net asset value treated as continuation of the original partnership.

# Partnership Divisions

## Treas. Reg. §1.708-1(d)



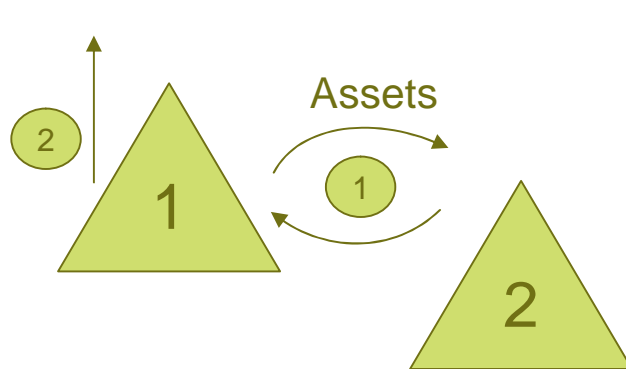
- AB divides into partnerships A and B
- A is a continuation of AB
  - 1 and 2 own more than 50% of AB
- B is a new partnership



- Net Asset Val = 100
- Net Asset Val = 60
- CD divides into partnerships C and D
  - FMV of C's net assets exceed D's
  - No form selected
  - C is a continuation of CD
    - greater net asset value
  - D is a new partnership

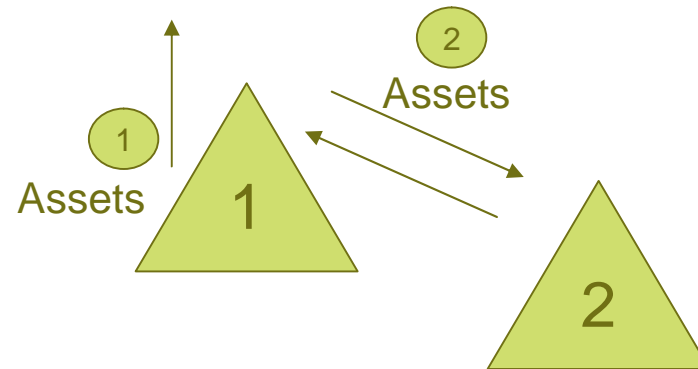
# Partnership Merger Treas. Reg. §1.708-1(c)

2 Forms:



“Asset Over”

- Default



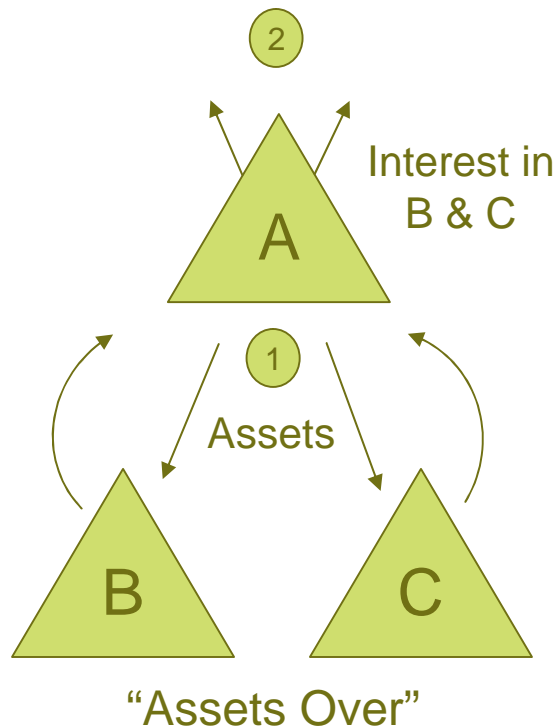
“Asset Up”

- §704(c)(1)(B)/ §737 triggered
- §732/ §723 may change basis
- Transfer tax
- Form respected if partnership titles assets in partners' names

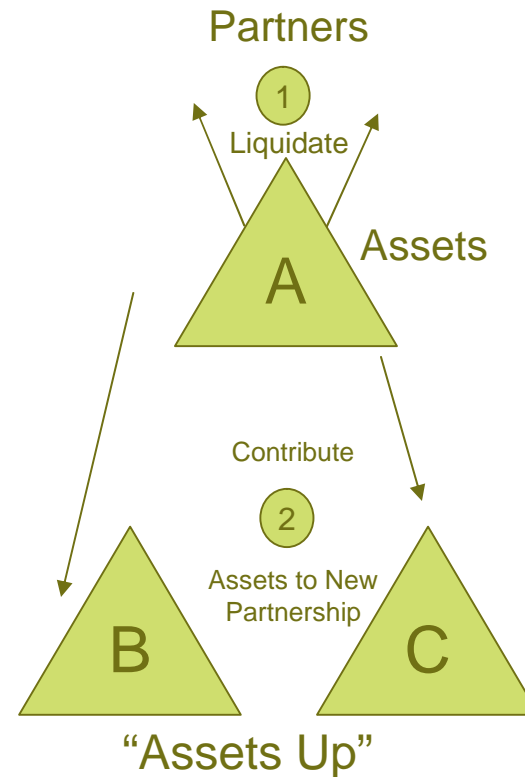
# Partnership Division

## Treas. Reg. §1.708-1(d)

2 Forms:



- Default rule
- § 704(c)(1)(B)/ § 737



- Form Respected if Partnership Titles Assets in Partners' Names

## Partnership Conversions

- Merger of Partnership into Corporation
  - Rev. Rul. 2004-59: applies to state law formless conversions
  - Check the box conversion regulation
  - Treated as “assets over”

## Moving on to Corporate Issues with Changes in Control

After an **Ownership Change**, a corporation may only use its **Pre-change Loss** to offset **Post-change Taxable Income** in an amount equal to the annual **Section 382 Limitation**.

## Ownership Change

Under very complex rules, an **ownership change** occurs when the **5% shareholders** of a corporation have increased their percentage ownership as of a **testing date**, in the aggregate, by more than 50 percentage points during a **testing period**.

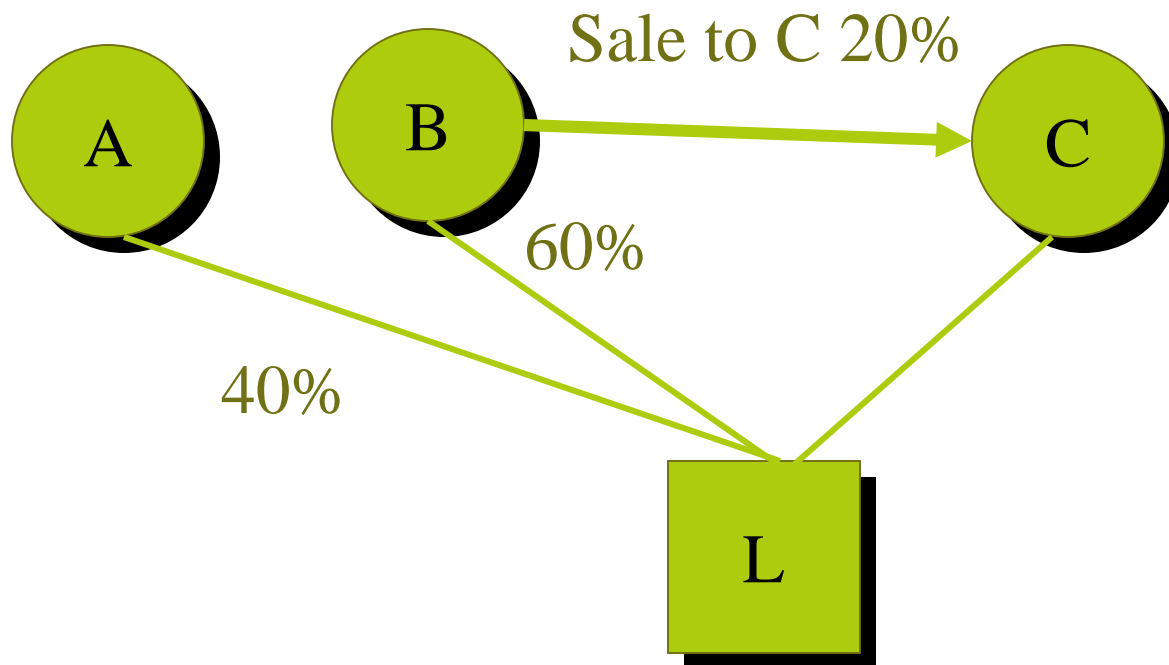
## 5% Shareholder

- An individual that owns by value, at any time during the testing period, 5% or more of the loss corporation's stock
- A public group of either the loss corporation, first tier entity, or higher tier entity identified under the aggregation or segregation rules
- Direct and indirect ownership interests of 5% or more must be added together creating a presumption of no cross ownership for less than 5% owners
- See LTR200818020 for guidance on filings of investment advisors

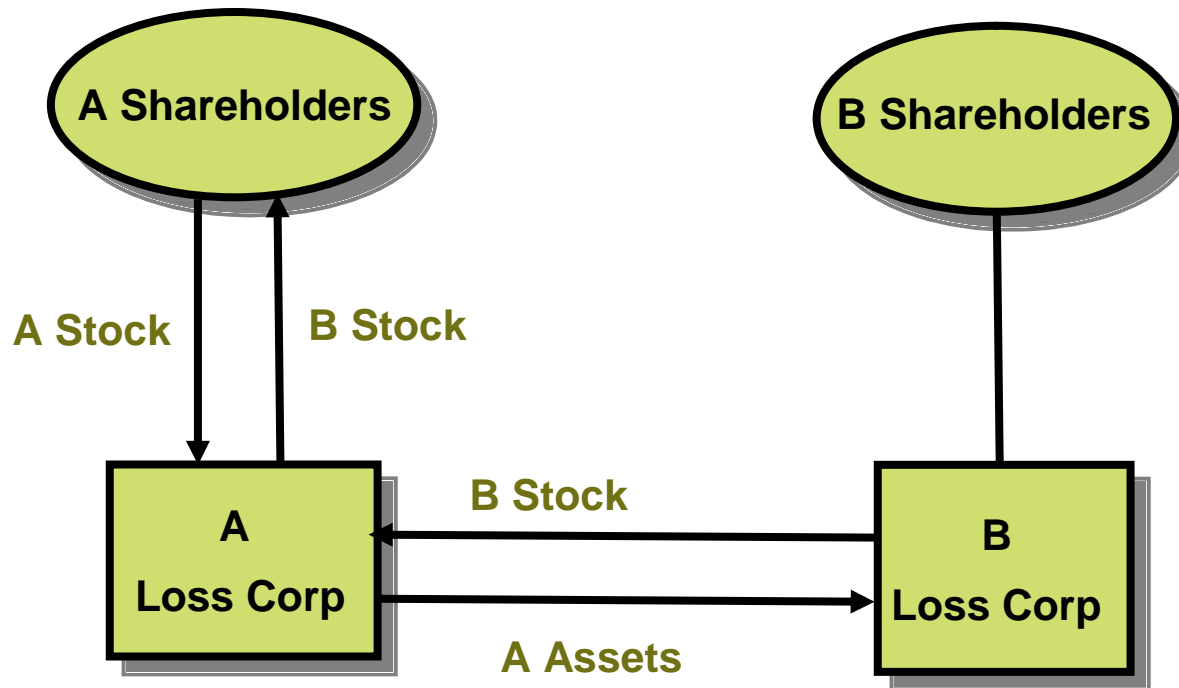
## Testing Date

- The date of any
  - Owner shift,
  - Equity structure shift,
  - If an option is considered exercised under the Regulations:
    - Transfer of an option to or by a 5% shareholder (or person who would be a 5% shareholder if option is exercised), or
    - Issuance of an option by the loss corporation or higher tier with a 5% or more interest
- All such transactions are treated as occurring simultaneously at the close of the testing date

# Owner Shift



## Section 382 Application in a Statutory Merger



## Testing Period

- Generally the three year period ending on the testing date; however, the testing period begins no earlier than the day following the last ownership change
- The testing period begins no earlier than the first day of either;
  - The first taxable year from which there is a loss carryover
  - The taxable year in which the testing date occurs
- If a corporation has a net unrealized built-in loss (NUBIL) on a testing date then 3 year testing period unless prove the year in which the NUBIL arose

## Loss Corporation

A **Loss Corporation** is a corporation which --

(A) is entitled to use a net operating loss, capital loss, foreign tax credit, general business credit or minimum tax credit carryover,

(B) for the taxable year that includes a testing date has any of the losses or unused credits listed above, or

(C) has a net unrealized built-in loss.

Any predecessor or successor to a loss corporation is also a loss corporation.

Treas. Reg. Section 1.382-2(a)(1)(I)

## Annual Section 382 Limitation

- The fair market value of all the stock of the corporation (adjusted for certain items) multiplied by the long-term tax-exempt rate.
- Highest of the long-term tax-exempt rates during the last three months.
- Published in the *Internal Revenue Bulletin* each month

## Adjustments in Value

### Value of All Stock (Including Pure Preferred Stock)

#### Decreased by:

- Anti-stuffing - contributions to capital within 2 years of the ownership change
- Redemptions
- Corporate Contractions
- Substantial Nonbusiness Assets (exception in legislative history for financial institutions)

## Additional Proposed Guidance Under Notice 2008-78

- Contributions will not reduce value unless it is part of a plan “a principal purpose” of which is to avoid or increase a §382 limitation
- **Safe Harbors**
  - Contributions made by a person who is not a controlling shareholder or related party and no more than 20% of value is issued
  - Contributions by a related party resulting in no more than 10% of value is issued
  - Contributions in exchange for stock issued in connection with the performance of services

## Substantial Nonbusiness Assets

- Value of loss corporation reduced by the fair market value of nonbusiness assets net of pro rata share of liabilities
- Substantial nonbusiness assets if at least 1/3 of the value of total assets consist of investment assets
- Exceptions for certain finance and investment companies

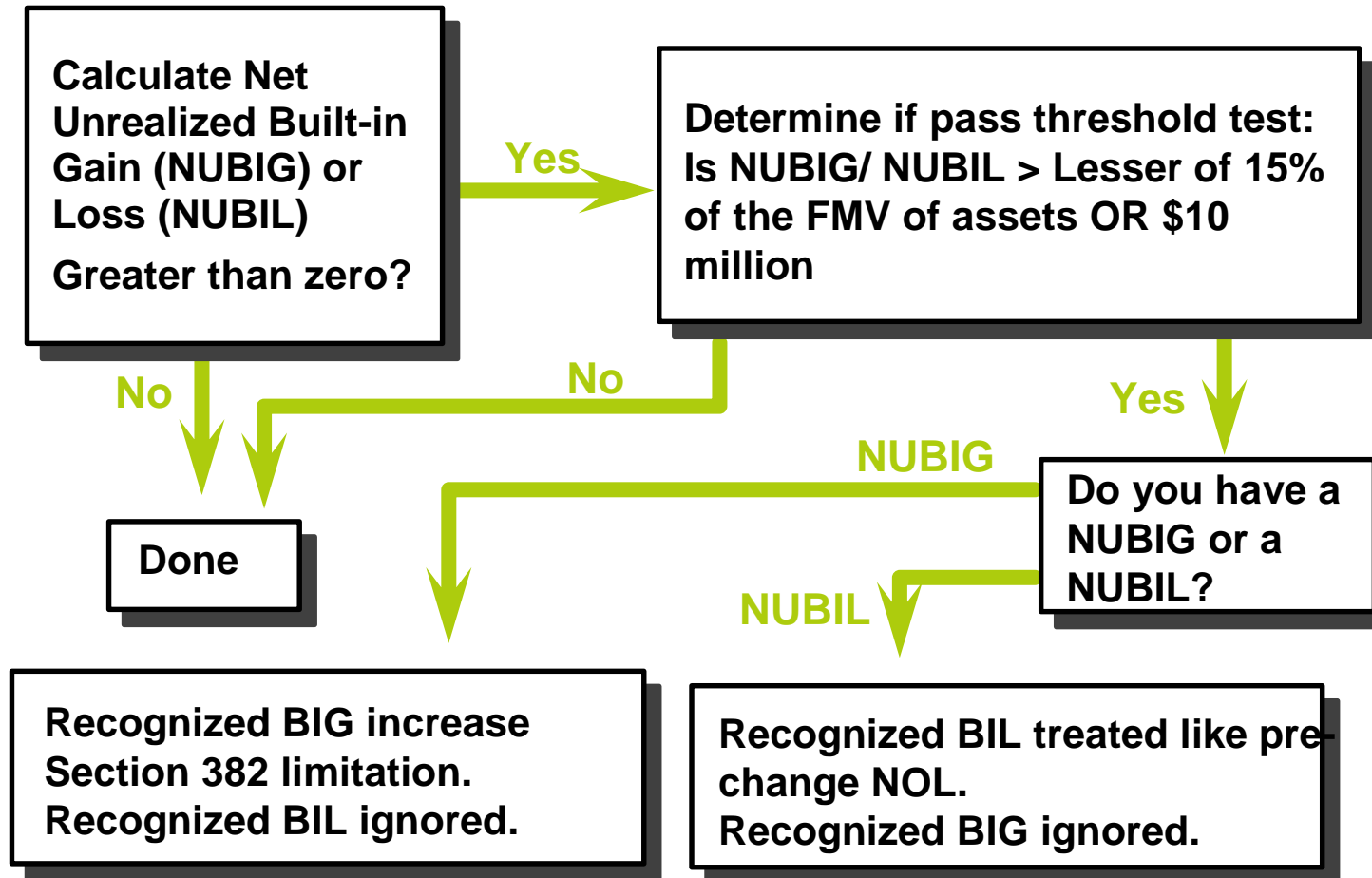
## Net Unrealized Built-In Gain

- § 382(h)(3)(A)(i) defines a net unrealized built-in gain as the excess of the FMV of all of loss corporation's assets over their adjusted basis, determined immediately before the ownership change.
- A recognized built-in gain is any gain recognized during a 5-year (60 months) recognition period on the disposition of any asset to the extent that the loss corporation establishes that it held the asset immediately before the ownership change date and such gain does not exceed the asset's built-in gain of such date.
- **The § 382 Limitation is increased for recognized built-in gains** only to the extent of the loss corporation's net unrealized built-in gain.

## Net Unrealized Built-In Loss

- § 382(h)(3)(A)(i) defines a net unrealized built-in loss as the excess of the loss corporation's adjusted basis in its assets over their fair market value, determined immediately before the ownership change.
- A recognized built-in loss is any loss recognized during a 5-year recognition period on the disposition of any asset except to the extent the loss corporation establishes that it did not hold the asset immediately before the ownership change date or such loss exceeds the asset's built-in loss as of such date.
- A recognized built-in loss includes any amount allowable as depreciation, amortization or depletion to the extent attributable to a NUBIL.
- **Recognized built-in losses are subject to the § 382** Limitation to the extent of the loss corporation's net unrealized built-in loss.

## Built in Gain or Loss Flowchart



## Income and Deduction Items

- An income or deduction item is any income or deduction which is recognized during the 5-year recognition period but which is attributable to the pre-change period
- Items of income and deduction are to be taken into account for purposes of the NUBIL or NUBIG calculation

## Example of Income and Deduction Items

- Wasting assets – Amortizable under § 197
- Contingent or “deductible” liabilities
- Items mentioned in the legislative history:
  - Accounts receivable of a cash basis taxpayer arising before the ownership change date but collected after that date
  - Gain on the completion of long term contract performed by a taxpayer using the completed contract method of accounting that is attributable to periods before the change date
  - Income attributable to periods before the change date pursuant to § 481 adjustments

## Notice 2003-65

Notice 2003-65 provides guidance on identifying built-in gain or loss items under § 382(h).

Two alternative approaches are approved:

- the 1374 approach
  - which is similar to § 1374 (dealing with S corporation conversion built-in gains)
- the 338 approach
  - which treats items similar to a deemed asset sale under § 338

## Agenda/Contents

1. Introduction / Recent Mining M&A Activity (10 minutes)
2. Mining Specific U.S. Tax Due Diligence Issues (10 minutes)
3. Change of Control Issues (35 minutes)
4. **Discussion of the Santa Fe Case (White Knight fee deductibility) (5 minutes)**
5. Recent Law Changes / Proposals (not industry specific – 20 minutes)
6. Questions (10 minutes)

## Transaction Costs – White Knights

- In a business/M&A context, a White Knight generally refers to a corporation, individual, firm, etc. that is a friendly acquirer in a hostile takeover attempt by another firm.
- Acquisition contracts with White Knights often include a termination fee that must be paid to the White Knight to 1) deter competing bids, and 2) to reimburse the White Knight for its time and effort in the event the deal does not go through.
- Reg. § 1.263(a)-5(C)(8) generally requires a taxpayer to capitalize these types of termination payments if they are paid to facilitate a second transaction with another party where the transactions are “mutually exclusive.”
- For purposes of this regulation, transactions are generally considered “mutually exclusive” if the occurrence of any one of the transactions implies the non-occurrence of the other transactions (e.g. a company that could not merge with both interested parties, or an acquirer that did not have the financial wherewithal to acquire both companies for which it had made bids.)

## Transaction Costs – White Knights

- In April of 2009, the Tax Court decided the Santa Fe Pacific Gold Company v. Commissioner case which appears to directly conflict with Reg. § 1.263(a)-5(C)(8) (as discussed above)
- In summary, the facts of the case were as follows:
  - Santa Fe Pacific Gold Company (“Santa Fe”) was spun off from its parent into a stand alone entity in 1994
  - Two years later, it faced a hostile bid takeover from Newmont USA Ltd. (“Newmont”) who was interested in Santa Fe’s land and mineral rights
  - To avoid being taken over, Santa Fe entered into a merger agreement with a “white knight,” Homestake Mining Co. (“Homestake”). The merger agreement between Santa Fe and Homestake provided for the payment of a \$65 million termination fee to Homestake should the agreement be terminated
  - Shortly after the agreement between Homestake and Santa Fe, Newmont made a larger offer that, in order to fulfill its fiduciary responsibilities, the Santa Fe board of directors accepted
  - This acceptance triggered the required \$65 million termination payment to Homestake
  - Santa Fe took a current deduction for this payment which was disallowed by the IRS

## Transaction Costs – White Knights

- The Tax Court sided with Santa Fe in this case and held that the Company was entitled to a deduction for the \$65 termination payment as either an ordinary & necessary business expense or an abandonment loss
- The Tax Court’s decision was premised on the fact that, in the court’s opinion, the termination fee paid to the white knight did not generate significant benefits for the taxpayer extending beyond the end of the taxable year, and that the two transactions involved in the hostile takeover were separate and distinct
- This holding appears to be in direct conflict with Reg. § 1.263(a)-5(C)(8) as this regulation seems to assume that in the context of a hostile takeover, a merger or takeover necessarily creates significant benefits for the target beyond the end of the year, and further that alternative merger transactions are necessarily “mutually exclusive”

## Transaction Costs – White Knights

- Though neither the IRS nor the Tax Court cited Reg. § 1.263(a)-5(C)(8) directly (as this regulation only applies to termination fees paid after Dec. 31, 2003 and the termination fee in question was paid in 1997) the holding in this case has raised questions for many tax practitioners as to the future application, interpretation, and, potentially, the validity of this regulation
- Thus, taxpayers with similar facts post-2003 may want to consider whether to challenge the validity of this regulation by arguing that a termination fee could not and did not create significant benefits for them extending beyond the end of the taxable year, and that the fee paid relates to a separate and distinct transaction that was abandoned as part of the hostile takeover

## Agenda/Contents

1. Introduction / Recent Mining M&A Activity (10 minutes)
2. Mining Specific U.S. Tax Due Diligence Issues (10 minutes)
3. Change of Control Issues (35 minutes)
4. Discussion of the Santa Fe Case (White Knight fee deductibility) (5 minutes)
5. **Recent Law Changes / Proposals** (not industry specific – 20 minutes)
6. Questions (10 minutes)

## President's Budget: International Tax Proposals

<b>Provision</b>	<b>10-Year Estimate</b>
Defer deduction expenses related to deferred income	\$ 51.5 billion
Determine foreign tax credit on a pooling basis	45.6 billion
Prevent splitting of foreign income and foreign taxes	10.2 billion
Limit shifting of income through intangible property transfers	1.0 billion
Reform business entity classification rules for foreign entities	31.1 billion
Limit earnings stripping by expatriated entities	1.5 billion
Prevent repatriation of earnings in cross-border reorgs	0.4 billion
Repeal 80/20 company rules	0.9 billion
Prevent the avoidance of dividend withholding taxes	1.2 billion
Modify tax rules for dual capacity taxpayers	7.2 billion
Address offshore tax noncompliance	8.8 billion
<b>Total</b>	<b>159.4 billion</b>

## President's Budget: Other Business Tax Proposals

<b>Provision</b>	<b>10-Year Estimate</b>
Codify economic substance doctrine	\$ 7.1 billion
Reinstate Superfund taxes	17.7 billion
Tax carried interest as ordinary income	23.1 billion
Repeal LIFO inventory accounting method	79.5 billion
Repeal LCM inventory accounting method	7.5 billion
Deny deduction for punitive damages	0.3 billion
Make research tax credit permanent	(67.9 billion)
Extend net operating loss (NOL) carryback period	(17.6 billion)
Extend subpart F active financing exception	(3.9 billion)
Extend look through of payments between related CFCs	(0.6 billion)

## Defer Deduction of Expenses Related to Deferred Income

### Current Law:

- U.S. expenses that support foreign-source income are currently deductible, whether or not that foreign-source income has been distributed.
  - Interest expense
  - R&D expense
  - Stewardship and headquarters expense

### Proposal:

- U.S. expenses – except R&D -- that support foreign-source income could not be deducted until sufficient foreign-source income has been taxed in the U.S.
  - Permitted Deduction =
  - $$\frac{\text{Current \& Deferred Expenses} \times \text{Currently-Taxed FSI}}{\text{Current FSI} + \text{Deferred FSI}}$$

## Reforming Business Entity Classification Rules ("Check-the-Box Repeal")

### Current Law:

- Certain foreign and domestic subsidiaries of U.S. companies that are owned 100% by a single parent shareholder can elect to be disregarded entities ("DEs"), treated as branches rather than separate corporations for U.S. income tax purposes.
  - Foreign DEs are widely used in global structures to mitigate Subpart F inclusions.

### Proposal:

- The President has criticized DEs as "disappearing subsidiaries" that erode the U.S. tax base.
- The 2010 Budget proposal would limit the use of DEs to:
  - DEs owned directly by a U.S. taxpayer (except in cases of "U.S. tax avoidance").
  - DEs owned by another entity in the same jurisdiction

## Reform the Foreign Tax Credit Indirect Foreign Tax Credit Pooling

### Current Law:

- A U.S. parent company may receive credit against U.S. income taxes for foreign income taxes paid by certain foreign subsidiaries on foreign-source income.
  - The U.S. parent company must receive a distribution from the foreign subsidiary in order to claim the “deemed-paid” indirect foreign tax credit.
- The amount of the indirect foreign tax credit can be no more than the U.S. tax would be on the foreign-source income (generally, 35%).
  - Except for certain deemed dividend inclusions (Subpart F, etc.), U.S. parent companies can generally choose each year which foreign earnings to distribute back to the U.S.
  - Thus, companies can manage their foreign tax credit situation using high-taxed foreign earnings or low-taxed foreign earnings, as appropriate.

## Reform Foreign Tax Credit Indirect Foreign Tax Credit Pooling

### Proposal:

- Under the Administration proposal, the deemed-paid (indirect) foreign tax credit would be calculated on an aggregate basis.
  - Foreign tax credits from high-taxed foreign earnings and low-taxed foreign earnings would effectively be blended to an “average” rate.
  - The blended rate would include not only foreign earnings that have been distributed but also accumulated foreign earnings that are not remitted to the U.S. parent.
- U.S. companies could no longer manage their foreign tax credit situation by choosing to distribute high-taxed or low-taxed earnings.

## Reform Foreign Tax Credit Prevent the Separation of Foreign Income from Taxes

### Proposal:

- The Administration proposes to “adopt a matching rule to prevent the separation of creditable foreign taxes from the associated foreign income.”
  - It is not clear whether proposed legislation will provide specific rules or just grant Treasury authority to issue new regulations.
- The new legislative proposal will likely be similar to the “technical taxpayer” regulations proposed in August 2006 but go further.
  - Those regulations deal with foreign consolidated groups and “reverse hybrids,” among other provisions.

## Taxation of Intangible Property Transfers

### Current Law:

- Companies transferring intangible property to foreign affiliates must generally pay tax on a deemed royalty payment to the U.S. transferor commensurate with the foreign affiliate's projected income from the transferred property.
  - Transfers of goodwill, going concern value, and workforce-in-place (or know-how) are generally exempt from this treatment.
- Some companies have tried to limit their tax on such transfers by
  - Characterizing most of the value of a transferred subsidiary as goodwill, going concern value, and workforce-in-place.
  - Using valuation methods that minimize the value of the transferred IP.

### Proposal:

- Proposed legislation would:
  - Include workforce-in-place, goodwill, and going concern value in the definition of intangible property for this purpose.
  - Direct that intangible property must be valued at its highest and best use.

## Codification of the Economic Substance Doctrine

### Currently:

- U.S. federal income tax law permits certain transactions to be undertaken without a tax cost when specific requirements are met.
  - For example, corporate reorganizations such as a state-law merger are not taxable under Internal Revenue Code (IRC) Section 368 if certain requirements of corporate control and consideration are met.
- The Economic Substance Doctrine is a “common-law” approach adopted by many U.S. federal courts that does not respect the tax results of a transaction unless
  - The taxpayer’s economic position undergoes a meaningful positive change in – beyond U.S. federal tax savings, and/or
  - The taxpayer has a business purpose for the transaction.

### Proposal:

- Codify the Economic Substance Doctrine as part of the Internal Revenue Code.

## Joint Committee on Taxation Explanations

- On September 14, 2009, the Joint Committee on Taxation ("JCT") released a pamphlet (JCS-4-09), that describes and analyzes the international tax proposals made by the Obama Administration in the federal budget for fiscal year 2010.
- The JCT pamphlet is thorough and detailed in its analysis of certain policy issues underlying the Administration's proposals and in a number of cases suggests specific rules to tighten these proposals.

## Key Points from the JTC

- The JCT believes that 10/50 companies would be included in both the expense deferral and foreign tax credit proposals, not just controlled foreign corporations (CFCs).
- The JCT suggests that expenses related to foreign income that is being recognized for U.S. tax purposes, such as foreign branch income and section 863(b) income, could be excluded from the expense deferral regime. However, the pamphlet also states that it would be simpler (though technically less accurate) to pool all such expenses with other foreign related expenses in order to determine the amount that would be deferred (based on the ratio of deferred foreign source income to all foreign source income). The pamphlet also questions the exclusion of R&E expense from the expense deferral regime.

## Key Points

- On the foreign tax credit blending proposal, the JCT suggests that the 2007 Rangel bill -- which would include direct section 901 credits in the pool -- would be a more effective approach. The JCT assumes that pre-effective date earnings would be included in the blending pool, and that low-tax earnings would be repatriated at the blended rate.
- On the proposal to scale back foreign disregarded entities, the JCT suggests that the proposal needs to be broader and stricter in order to prevent tax planning that could circumvent the stated purposes.
- On the proposal to limit income-shifting through transfers of intangible property, the JCT pamphlet views the proposal as aimed primarily at workforce-in-place for foreign companies (as a separately identifiable asset), but it makes suggestions about tightening section 482 rules governing cost-sharing and the commensurate-with-income standard.

## Key Points

- On the proposal to prevent repatriation of earnings through cross-border "Cash D" reorganizations, the JCT suggests the proposal may need to be broader and stricter in order to avoid creating new tax planning opportunities
- The pamphlet acknowledges that the effect of the expense deferral proposal on US investment and wages is uncertain
- The JCT recognizes that the major proposals, taken together, might discourage multinational companies from being resident in the United States and might discourage some U.S.-based multinationals companies (MNCs) from repatriating foreign earnings. The JCT has little to say about the global competitiveness of U.S. companies, or divergence of the Administration's proposals from international norms

## Agenda/Contents

1. Introduction / Recent Mining M&A Activity (10 minutes)
2. Mining Specific U.S. Tax Due Diligence Issues (10 minutes)
3. Change of Control Issues (35 minutes)
4. Discussion of the Santa Fe Case (White Knight fee deductibility) (5 minutes)
5. Recent Law Changes / Proposals (not industry specific – 20 minutes)
6. **Questions** (10 minutes)

# Thanks, feel free to ask questions.....

© 2009 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP (a Delaware limited liability partnership) or, as the context requires, other member firms of PricewaterhouseCoopers International Ltd., each of which is a separate and independent legal entity.  
\*connectedthinking is a trademark of PricewaterhouseCoopers LLP.

PRICewaterhouseCOOPERS 