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April 15, 2012
Volume 38, No. 7

Is the Economic Substance Doctrine a Kind of Tax Porn?

The IRS Adopts a "Don't Ask, Won't Tell" Policy

BY JOSEPH B. DARBY III (GREENBERG TRAURIG LLP)

One of the most famous lines ever to appear in a United States Supreme Court opinion was penned by Justice Potter Stewart, who wrote, "I know it when I see it."

The "it" that Potter Stewart felt certain he knew when he saw was hard-core pornography. Stewart's full quote, from the case *Jacobellis v. Ohio*, 378 U.S. 184 (1964), is as follows:

"I shall not today attempt further to define the kinds of materials that I understand to be embraced within that shorthand description [i.e., the term "hard-core pornography"]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that."

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Unintended Consequences:

The Volcker Rule and Securitization

BY HARRY J. HUTTON (DLA PIPER (US))

It appears that the effective date of the Volcker Rule (adopted by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") as an amendment to Section 13 of the Bank Holding Company Act of 1956) will either be pushed back or suspended until after the adoption of final regulations, which have yet to be issued. The statutory effective date for the Volcker Rule is the second anniversary of the adoption of the statute or one year after the issuance of final regulations, whichever is earlier. As the second anniversary of the statute is July 21, 2012 and no final regulations have been issued, the statute requires that the Volcker Rule become effective this July.

According to Federal Reserve Governor Daniel Tarullo in a statement to the Senate Banking Committee, "there is obviously a real possibility that we don't meet the July 21st date." The issuance of final regulations is not imminent, and thus there is a possibility that the rule could become effective this summer without regulations in place. A bi-partisan bill has been introduced in the Senate that would delay the effective date of the rule for one year after the adoption of final regulations. Statements have been made by federal regulators, including Chairman of the Federal Reserve Ben Bernanke, that the rule wouldn't be enforced without final regulations.

Notwithstanding the comments of Chairman Bernanke and others that the Volcker Rule would not be enforced without final regulations in place, there is real

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US's Volcker Rule and Securitization
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Now comes the Internal Revenue Service, here to explain the meaning and import of the so-called "Economic Substance Doctrine." This is a long-standing common-law (judge-made) doctrine that was formally enacted and codified in 2010 by the U.S. Congress, and that presently resides in the Internal Revenue Code, with an address located at Section 7701(o)[1] Bear in mind that the codification of the Economic Substance Doctrine has caused massive consternation among tax practitioners and taxpayers alike: It is the greatest source of caterwauling and gloomy predictions since the U.S. invaded Iraq or the Kardashians first appeared on TV.

The problem is that the Economic Substance Doctrine shares one dominant trait with hard-core pornography: Both are exceedingly difficult to define. Indeed, in Notice 2010-62, issued shortly after the codification was enacted, the IRS ostentatiously announced that it had absolutely nothing to announce—that it was going to take a page from Potter Stewart and not make any effort whatsoever to try and define one of the most important—not to mention prurient—subjects in tax law today.

In Notice 2010-62, the IRS conspicuously declined to identify transactions that it considered safe from challenge under the Economic Substance Doctrine. It also declined to identify transactions that it felt came within the Economic Substance Doctrine. Then, to top it all off, the IRS also announced that it would not issue private letter rulings with respect to the "relevance" or application of the doctrine.

What the IRS was announcing—between the lines, but very clearly—was that the IRS itself is having a difficult time defining what the Economic Substance Doctrine *really* means, but, rest assured: When it comes to economic substance, the IRS *knows it when it sees it*.

The purpose of this article is to take a close look at the Economic Substance Doctrine (hereafter the ESD), peek behind the curtains and under the covers to get a glimpse at the IRS's thinking on this new statutory provision, and ultimately provide a full-frontal view of this new and revealing body of law as it may apply to a host of currently common international tax and business transaction structures.

Section 7701 (oh!)

After a long and quixotic history as a well-intentioned but unevenly applied common law doctrine, the ESD was formally embraced by Congress in March 2010[2] and is now embodied in new Section 7701(o). (Section 7701(o) created such an immediate sensation among tax practitioners that it was promptly dubbed "Section 7701 (oh!).") As described by Congress (with more or less a straight face), the new provision was not supposed to represent a substantive change in the law, but rather was intended merely as a codification of the existing common law doctrine, together with a "clarification" that, on the surface, is merely supposed to resolve and reconcile conflicting interpretations of certain technical aspects of the doctrine.[3] However, the fact that Congress went to the conspicuous trouble of codifying the ESD, coupled with some attention-grabbing penalty provisions (a 40 percent penalty if a transaction is found to lack economic substance, which is reduced to a 20 percent penalty even if all relevant facts are disclosed), meant that the ESD was

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Practical International
Corporate Finance Strategies

The International Business Information Source™
(ISSN 1070-9215)

EDITORIAL OFFICE
WorldTrade Executive,
part of Thomson Reuters
P.O. Box 761
Concord, MA 01742-0761/USA
(978) 287-0301 Phone
(978) 287-0302 Fax
www.wtexecutive.com

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PUBLISHED TWICE A MONTH FOR SUBSCRIBERS ONLY

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SUBSCRIPTION INFORMATION: Annual subscription: US$1405 (add $50 for non–US postage) Single copy: US$65

Agreement on Government Procurement (GPA2)

BY NICOLE KEHOSKIE, ESQ. AND DONNA BADE, ESQ.
(SANDLER, TRAVIS & ROSENBERG, P.A.)

After ten years, the parties to the World Trade Organization's Agreement on Government Procurement (GPA) recently reached a historic understanding to improve and expand market access for government procurement suppliers. The new agreement (GPA2 or new Agreement) has been heralded as a much-needed stimulus for improving the world economy because of its effect on a wide variety of industries, including infrastructure, public transport, hospital equipment and other service providers to governments. The expansion includes access to the government procurement of sub-central entities and also added services to the available GPA procurement activities. This article will discuss the new agreement and how it will benefit North American government suppliers in the future.

Overview of the GPA

The Agreement on Government Procurement is the only legally binding agreement in the WTO that focuses on the subject of government procurement. The original GPA entered into force on January 1, 1996. It is a plurilateral treaty, administered by a Committee on Government Procurement, and includes only those WTO members (currently numbering 41) that have specifically agreed to become parties. Mexico is not a signatory to the GPA nor does it have observer status. Therefore, when discussing the impact of the new GPA on North American government suppliers, we are talking about Canada and the United States.

The main premise of the agreement is to apply non-discriminatory practices to government procurement laws so that each party treats domestic and foreign contracts alike, conferring on other parties "no less favorable" treatment than that given to domestic bids. Additionally, the GPA encourages transparency of laws, regulations, procedures and practices regarding government procurement by requiring government procurement laws to be published. In addition, each government must provide statistics on its procurement covered by the agreement.

In practice, the GPA covers only those goods above a specific threshold amount, which is periodically set by the member states. Currently, the United State' thresholds are 202,000 USD for goods and services and 7,777,000 USD for construction services. For Canada, the thresholds are 205,100 CAD for goods and services and 7,800,000 CAD for construction. This means that contracts under these thresholds are not subject to the GPA and are allowed to be protected from foreign competition via domestic laws.

Although the expanded WTO Agreement on Government Procurement broadens market access for government procurement suppliers, this expansion will have the most significant impact by providing incentives for China to open its government procurement market to GPA members.

New Agreement

The GPA2 was negotiated during the Eighth Ministerial Conference of the WTO in December 2011 and is expected to bolster the prior agreement in several areas, including (1) more structure to the contract award process, (2) greater fiscal responsibility by better use of public resources, (3) creating economic stimulus by providing for access to sub-central government procurement contracts and adding services to the agreement, (4) accelerating accession to the GPA for countries such as China and India, and (5) new transparency rules to fight corruption, including the use of electronic reporting methods.

The obvious universal benefit of the GPA2 is new market access for government suppliers of goods and services. This market access is much anticipated in the current economic environment and is estimated to be worth about $80-100 billion. Since central and sub-central government procurement makes up an estimated 10-20 percent of most countries' GDP, expanding the agreement opens up many new markets for export. The GPA2 also puts countries on the same playing field by closing the gaps in the previous agreement that allowed countries to subvert the GPA via local governments' allowable protectionist policies. The downside is that local government procurement suppliers will no longer enjoy the benefit of pro-

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tection against foreign competition, although only a minority of domestic government procurement businesses actually enjoyed such protection.

In actuality, the GPA only covers central and sub-central government entities listed in Annexes 1-3 of Appendix 1 of goods, services and construction services that are specified in the GPA. Furthermore, as previously discussed, the government contract must be greater or equal to a certain threshold amount. As we will see below, the new agreement does not change this mandate.

The GPA2 opens up new central and sub-central (regions, provinces (states), municipalities) government procurement to GPA member countries.

North American Government Procurement

The financial impact of the GPA2 on North American government procurement suppliers is two-fold. First, the GPA2 opens up new central and sub-central (regions, provinces (states), municipalities) government procurement to GPA member countries. Two consequences of this new market access for North American suppliers are: (1) less protection for domestic suppliers who provide to state/local government entities; and (2) domestic suppliers' ability to source components and finished products from GPA member countries. Second, GPA2 facilitates the accession of key economies to the GPA, including Russia (currently a non-WTO member), China and India, which assures more transparency in international business transactions governed by the WTO and increases the government procurement market access tremendously. The following discusses these effects in more detail.

New Central and Sub-Central Market Access of Current GPA Members

With regard to the opening of sub-central government procurement to GPA member states, the up-side is that North American government suppliers will have much greater access to a much larger market. In theory at least, this promotes overall exports from the United States and Canada. The sub-central government procurement markets to be accessed include an estimated 200 new ministries, government agencies and other entities of current GPA members, representing tens of billions of dollars in increased procurement sales. The downside is that domestic U.S. and Canadian suppliers previously protected from GPA-origin products will now potentially be subject to foreign competition from GPA member states. This disadvantage is mainly overshadowed by the market increase created by GPA2, at least for those domestic suppliers with contracts above the GPA thresholds. By way of example, North American suppliers will now have access to the total government procurement market of the EU, which accounts for about 3.5 percent to 17 percent of the EU's GDP, depending on the analysis. This accounts for an upwards amount of 2.1 trillion euros in public procurement. The drawback of foreign competition is also relieved by the ability of domestic suppliers to source their products from GPA member countries with lower labor costs. It should be emphasized that government procurement regulations limit the acquisition of foreign products, not contracts with foreign suppliers. Accordingly, a long problem for North American suppliers, namely not being able to source their products from China or India, will be eliminated by GPA2.

In addition, the negative impact of foreign competition is ameliorated somewhat by the fact that GPA market access will remain subject to the specified contract value thresholds. In other words, local government procurement becomes accessible by GPA suppliers only after the value of the contract meets the current threshold. The degree of protection afforded to domestic procurement contracts under the threshold amount does not change. Under both agreements, the protective measures are generally not absolute because, in most instances, foreign companies are still allowed to bid after their bid price is adjusted upward. In sum, if the government contract is above the threshold set for a particular trade partner, GPA member suppliers bid on equal footing with North American companies, and because of GPA2 this applies to both federal and local government contracts.

The addition of new central and sub-central government procurement markets via GPA2 is less significant for trade between the North American countries. For one, Mexico is not a member of the GPA and is therefore unaffected by the changes to the agreement. Furthermore, the U.S. and Canada implemented on February 16, 2010, the U.S.-Canada Agreement on Government Procurement, under

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which the sub-federal markets of both countries are mutually accessible. Additionally, although the new central/sub-central markets may be globally significant, they become less so when viewed in light of the current top export markets for both Canada and the U.S. In 2011, the three top export markets for the U.S. were Canada (19 percent of total U.S. exports), Mexico (13.3 percent), and China (7.0 percent), with the remaining top 15 export countries accounting for between 1.7 percent and 4.5 percent each. Since the two largest U.S. export markets are unaffected by the GPA changes, it remains to be seen how significant the changes will be to the U.S. market for countries that purchase relatively small percentages of total U.S. exports. Obviously, the most significant market after Canada and Mexico is China, and its accession, as promoted by the new GPA2, will have the greatest impact on U.S. government procurement suppliers.

The story is quite similar for Canada, with an even less pronounced potential financial impact. The predominant purchaser of Canadian exports is the United States, which purchased about 75 percent of total exports from Canada in 2009. The second and third largest export countries were the UK at 3.4 percent of total Canadian export, and China at 3.1 percent. Again, it is the access to the large Chinese government procurement market that will provide the most benefit to Canadian government suppliers. The GPA2 provides no greater benefits for Canadian exports to the U.S., which already enjoys access to state and local government contracts via the U.S.-Canada agreement. The primary benefits for North American government suppliers from the accession of WTO members to the GPA2 are discussed below.

GPA Accession

The larger impact of the GPA2 is in bringing within the scope of the agreement some significant procurement markets, including of current WTO members China and India and non-WTO member Russia. China's central government procurement market is estimated to be worth 88 billion USD annually in goods and services, while China's total government procurement market (including central, sub-central and other government entities) is estimated at 1.02 trillion USD, or 20 percent of China's GDP. India's government procurement market is estimated at 347.8 billion USD, or 30 percent of GDP.

To put this in relative terms, the total U.S. government procurement market for fiscal year 2012 is projected to reach 2.99 trillion USD, down slightly from 3.03 trillion USD in 2011, according to Waltham, Mass.-based economic forecaster IHS Global Insight. Of that amount, federal government purchases of goods and services will total $.22 trillion USD in 2012 while state and local government purchases will reach 1.77 trillion USD. Of course, it is unclear how reliable these statistics are given the discrepancy between statistics calculated by private industry and those reported by the U.S. government to the WTO. According to the United States' Article XIX: 5 Report to the GPA, total federal government procurement in 2008 was about 666 billion USD, which does not account for state or local government procurement. About 1 percent, or 8 billion USD, of this market fell below the GPA thresholds and was therefore not subject to foreign competition. 666 billion USD is about half of the 1.2 trillion USD projected by IHS Global Insight. Even taking into account the four-year gap between the reported data and that projected for 2012, there is a huge discrepancy, which impacts how much potential financial gain is available for U.S. government suppliers.

The larger impact of the GPA2 is in bringing within the scope of the agreement some significant procurement markets, including of current WTO members China and India and non-WTO member Russia.

According to the Canadian government, its total government procurement market accounts for approximately 14 billion CAD per year. In 2008, Canada reported that its federal government purchased approximately 3.9 billion CAD in goods and services. Obviously, the much larger markets made available by the GPA2 will have some effect in the Canadian government supply industry, but given that 75 percent of exports are sent to the U.S., this impact is not likely to be substantial to the overall Canadian economy. As previously mentioned, it should be noted that accession of these countries to the GPA will impact the U.S. government procurement market in two ways other than affording North American suppliers access to new markets. First, U.S. suppliers to the U.S. government will now be able to source their products from GPA members. Second, other foreign suppliers to the U.S. government will be

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able source their products from China and India. Remember, it is the origin of the product, not the supplier, whose access will principally change the public procurement arena. Although there may be an influx of new Chinese suppliers in the U.S. procurement market, the real impact will be made by the fact that Chinese-produced products will now be treated on equal footing with other products' origins. This, more importantly, allows U.S. suppliers to source their products from China. The benefits, then, become that North American suppliers have access to larger markets, and have the ability to source the products from less expensive labor markets.

Conclusion

In sum, although the expanded WTO Agreement on Government Procurement broadens market access for government procurement suppliers, this expansion will have the most significant impact by providing incentives for China to open its government procurement market to GPA members. Another important impact for North American suppliers to the U.S. and/or Canadian governments, in particular, is the ability to source their products from less expensive labor markets. Thirdly, GPA2 will provide additional export opportunities by way of new central and sub-central governmental markets. However, it remains to be seen what the overall impact will be on either U.S. or Canadian suppliers given the U.S.-Canada agreement already in place. ❑

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Competition

UK Competition Commission Requires U.S. Company Unwind Completed Acquisition

BY MATT EVANS AND MARGUERITE LAVEDAN (JONES DAY)

On March 21st, the Competition Commission ("CC") announced that it will require U.S. firm Stericycle to sell Ecowaste Southwest Limited ("ESL") – a company it bought just over a year ago. On what basis has the buyer found itself in such an unsatisfactory situation? The answer probably lies somewhere between the "voluntary" nature of the UK merger control regime, an apparently high-risk strategy by Stericycle, and possibly the increasingly active policy by the OFT to investigate completed deals.

Key Features of UK Merger Control

UK merger control law operates a so-called voluntary notification system, whereby an acquiring party can complete and implement its deal without notifying the UK Office of Fair Trading ("OFT") for merger clearance. However, whether or not a completed deal is notified, the OFT has power to investigate it on its own volition. If it establishes jurisdiction, the OFT has four months from the date that the deal was made public – or if not publicized, from the date that it was brought to the OFT's attention – in which to decide whether to refer the deal to the CC for an in-depth review.

The OFT may assert jurisdiction over a deal if either the target's annual UK sales exceeded £70 million (US$112 million) in the previous financial year or between them the merging parties purchase or supply 25% of the same category of goods or services in the UK or part of the UK.

From Voluntary Non-notification to Compulsory Divestiture

Stericycle's UK subsidiary provides waste management services to medical and other sectors

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in England and Wales. It acquired ESL in January 2011. ESL provides medical waste management services in the south west of England. Its annual UK turnover was just £1.5 million and it was experiencing financial difficulties. Stericycle did not issue a press release following completion of the acquisition, and none of the national, regional or trade press mentioned it. Therefore, material facts about the transaction were not "made public" so as to start the four month statutory clock following completion of the acquisition.

The OFT found out about the deal, perhaps by a complaint or on its own, and issued an enquiry letter to Stericycle in May 2011, following which it commenced a merger review. The OFT asserted jurisdiction based on the share of supply test. The parties had an estimated national combined share of supply of 20-30% of overall clinical waste treatment. But the OFT defined the geographic market more narrowly, as regional, and found that the parties had a share of supply of approximately 50-60% around the city of Bristol, where ESL was based. The OFT found that the merger had resulted or could be expected to result in a substantial lessening of competition, and therefore it referred the merger to the CC.

The CC confirmed the OFT's finding that the merger could be expected to result in a substantial lessening of competition. Prior to the merger, the parties were each other's closest competitors within both a 50 and 100 mile radius of Bristol, and the merged entity would not be sufficiently constrained by competitors. The CC acknowledged ESL's financial difficulties, but decided that it could have been sold to an alternative purchaser. In light of this, the CC considered several remedies, having regard to the effectiveness of the remedy options as well as their cost and proportionality. However, it concluded that only the full divestiture of ESL would be effective and proportionate.

Stericycle will now have to sell ESL in a short time frame – even if at a loss, a possibility the CC disregards when it is considering a divestment remedy. The CC considers that it is for acquirors to factor into the acquisition price the risk that a completed merger could be subject to a divestment remedy.

Lessons Learned

A full divestment order in a completed deal is rare. The current merger control regime became effective in June 2003, and since then the CC has issued 90 merger decisions. Of these, the CC has blocked just 5 anticipated mergers and required full divestments in 5 completed merger cases, or 14 when partial divestiture remedy decisions are added.

This latest CC decision should be read in the more general context of the increasingly aggressive approach of the OFT in asserting jurisdiction over completed deals in recent years – sometimes even without regard to the existence of prima facie competition concerns. This case serves as a reminder that the OFT monitors the market and there is a high risk that deals that are not notified to it will be uncovered and investigated. As described above, there are two alternative jurisdictional thresholds – based on revenues and based in shares – and therefore even if the target has little turnover in the UK the OFT still may have jurisdiction to investigate based on the parties' share of supply. In the words of former CC chairman Peter Freeman "while parties are entitled to complete mergers in the UK regime, they do so at their own risk".

Companies wishing to take advantage of the flexibility this offers must fully assess the risks of a decision not to notify – including an expensive merger review later on and a possible fire sale of the acquired business at some point in the future.

The UK government has recently confirmed that it intends to retain the "voluntary" nature of UK merger control. Companies wishing to take advantage of the flexibility this offers must fully assess the risks of a decision not to notify – including an expensive merger review later on and a possible fire sale of the acquired business at some point in the future. ❑

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Snapshots

BY REUTERS

China Foreign Investment Quota Boost Aimed at ETFs

China's expansion of a quota for investment of offshore yuan back into mainland financial markets will be used mainly to promote Hong Kong-listed exchange-traded funds (ETFs) that track the mainland stock market, Chinese media reported this month.

China's expansion of a quota for investment of offshore yuan back into mainland financial markets will be used mainly to promote Hong Kong-listed exchange-traded funds that track the mainland stock market.

The 50 billion yuan ($7.92 billion) expansion of the Renminbi Qualified Foreign Institutional Investor (RQFII) program, announced earlier this week, is targeted at equity investment and not subject to previous rules stating that a maximum 20 percent of the total RQFII quota can be invested in equities, the official Shanghai Securities News reported, citing a "related person in charge" at the securities regulator.

The move is designed to promote the development of Hong Kong-listed ETFs that track the mainland A-share index or components of it, the report said. Specific ETF offerings will be approved by Hong Kong's Securities and Futures Commission.

China hopes the roll-out of ETFs will encourage stable, long-term foreign investment, the paper quoted its source as saying.

The China Securities Regulatory Commission announced on Wednesday the total RQFII quota would be raised from 20 billion yuan to 70 billion yuan, though the allocation of the increased quota to individual fund companies licensed under RQFII will occur gradually.

RQFII, launched in December, allows offshore yuan in Hong Kong - accumulated mainly as a result of China's cross-border yuan trade-settlement program - to be recycled back into mainland financial markets.

The scheme is part of China's broader goal of promoting greater use of its currency as an alternative to the U.S. dollar for international trade and investment.

Global Business Groups Warn India Over New Tax Plan

International trade groups representing more than 250,000 companies have told Indian prime minister Manmohan Singh in a letter that his government's new retrospective tax proposals have led foreign businesses to reconsider their investments in the country.

India's federal budget last month outlined a proposal to enable the tax authorities to make retroactive claims on overseas corporate deals and bring in new anti-avoidance measures, moves that have been criticized for further denting investor sentiment.

This month the UK's finance minister George Osborne also raised his concerns over the issue with his Indian counterpart.

The letter from seven foreign business groups delivers the broadest criticism yet made by the overseas business community of an Indian government that has failed to enact economic reforms to spur investment and revive growth.

"The sudden and unprecedented move (on tax) ... has undermined confidence in the policies of the Government of India towards foreign investment and taxation and has called into question the very rule of law, due process, and fair treatment in India," the groups said in the March 29 missive to Singh.

"This is now prompting a widespread reconsideration of the costs and benefits of investing in India," continued the letter, signed by bodies including the U.S.-based Business Roundtable, the Confederation of British Industry, the Japan Foreign Trade Council and Canadian Manufacturers & Exporters.

The Business Roundtable is chaired by Boeing's BA.N chief executive, James McNerney, and represents companies with more than $6 trillion in revenues.

India's reputation among global investors has taken a beating over the past year as the government has lurched from crisis to crisis, including a botched attempt to allow foreign supermarkets

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into the country and a long-running stand-off with South Korea's POSCO 005490.KS over a $12 billion steel plant.

Sluggish investment is partly to blame for slowing growth in Asia's third-largest economy, which grew an annual 6.1 percent in the December quarter, the weakest in nearly three years.

Increasing Uncertainty

More recently a long-running tax struggle between London-listed Vodafone Group Plc VOD. L, India's largest overseas investor, and the Indian government has come to symbolize the perils facing foreign investors in the country.

Vodafone won a five-year legal battle in January when India's Supreme Court dismissed a demand made by the Indian authorities for a $2.2 billion capital gains withholding tax on the British company's acquisition of Hutchison Whampoa Ltd's 0013.HK Indian mobile assets in 2007.

That ruling was hailed by business groups as a victory for clarity in the country's investment climate, which has suffered due to policy paralysis, regulatory uncertainty and widespread corruption allegations against the government.

But the proposal in the recent budget to retroactively impose a capital gains tax on merger and acquisition deals conducted overseas where the underlying asset is located in India would amend 50-year-old-tax laws and allow New Delhi to pursue taxes on long-concluded transactions.

"We are concerned about the proposed budget measure," Osborne told reporters after his closed meeting with Mukherjee.

"Not just because of its impact on one company, Vodafone, but because we think it might damage the overall climate for investment in India."

"What India needs, like all countries, is a stable and predictable tax system to encourage investments, and we have concerns that this budget proposal would not add to that," Osborne said, adding he had raised his concern with Mukherjee.

Parliament is expected to consider the new tax proposals during the last week of April.

The proposals, if written into law, could also affect Kraft Foods Inc' s KFT.N 2010 acquisition of Cadbury's Indian business and deals involving Indian assets sold by AT&T Inc T.N and SABMiller Plc's SAB.L purchase of Fosters.

"Some of our member companies had already begun re-evaluating their investments in India due to increasing levels of controversy and uncertainty regarding taxation in recent years," the collective letter to Singh said.

Foreign direct investment (FDI) in India stood at $35.3 billion in the first nine months of the 2011-12 fiscal year, powered by two multi-billion-dollar energy deals, more than the $32.9 billion registered in the 12 months to March 2011, according to data from the Reserve Bank of India.

India needs increasing FDI and foreign institutional inflows to offset a rising trade deficit, which is likely to have hit $175 to $180 billion in the year that ended in March.

"India will lose significant ground as a destination for international investment if it fails to align itself with policy and practice around the world," the letter said.

India needs increasing FDI and foreign institutional inflows to offset a rising trade deficit, which is likely to have hit $175 to $180 billion in the year that ended in March.

Turmoil in Telecoms

Vodafone said on March 30 it was considering a number of actions after the budget proposal, which it described as "grossly unjust".

In a March 26 letter to Singh, Vodafone's chief executive Vittorio Colao said the budget proposal contained "extraordinary retrospective provisions, going back 50 years and removing the protection of the courts from investors".

"Arbitrary and punitive retrospective treatment of one of India's most prominent long-term foreign investors by the tax authorities could only tarnish the image of India as a destination for inward investment," he wrote in the letter, a copy of which was seen by Reuters.

Confusion already reigns in India's telecoms market since the Supreme Court last month ordered all 122 mobile network licences awarded in a scandal-tainted 2008 sale be revoked.

As a result Abu Dhabi's Etisalat ETEL. AD has already announced the winding down of its Indian operations. Meanwhile Norway's Telenor TEL.OL has been embroiled in a dispute with its Indian partner, Unitech Ltd UNTE.NS, and has said it would seek to move the business to a fresh venture with a new partner. – *By Henry Foy and Matthias Williams (Reuters)* ❑

Foreign Exchange Rates and Forecasts for the Asia/Pacific Region

CURRENCY FORECASTS ©
AND THE ECONOMIST INTELLIGENCE UNIT

Australia

Buoyed by high prices for commodity exports and the wide interest rate differential with other developed economies, the Australian dollar has performed strongly against the US dollar in the past 12 months, reaching a 29-year high of A$0.89:US$1 in July 2011. However, the country's onerous foreign debt-servicing obligations make the Australian dollar a risky currency to hold, and it is thus exposed to any rise in investor risk aversion. Following an average exchange rate of A$0.97:US$1 in 2011, a moderation in global prices for commodities (which make up a large proportion of Australia's exports) will cause the currency to depreciate marginally in 2012, to an average of A$0.99:US$1. We expect the local currency to continue to weaken very slowly in the first half of the forecast period, reaching a low of A$1.09:US$1 in 2014, before appreciating gradually in the remainder of the period, to average A$1.03: US$1 in 2016.

Australia

	2011	2012	2013	2014	2015
A$:US$ (av)	0.97	0.99	1.05	1.09	1.06
Nominal appreciation of A$ (%)	12.2	-2.2	-5.3	-3.3	2.4
Real appreciation of A$ (%)	13.0	-2.0	-4.6	-3.6	2.5
A$:US$ (end period)	0.98	1.03	1.09	1.08	1.05
A$:€ (av)	1.35	1.30	1.35	1.38	1.31
Nominal appreciation of A$ (%)	7.3	3.8	-3.8	-1.8	4.8
Real appreciation of A$ (%)	8.2	4.3	-2.2	-1.3	5.8
A$:€ (end period)	1.31	1.33	1.40	1.35	1.32
A$:¥100 (av)	0.89	0.92	0.99	1.03	1.02
Nominal appreciation of A$ (%)	5.2	-3.3	-6.6	-4.2	1.4
Real appreciation of A$ (%)	8.9	-0.9	-3.9	-2.5	3.1
A$:¥100 (end period)	0.91	0.97	1.03	1.03	1.01
Real effective exchange rate (1997=100)	98.2	107.1	109.8	109.0	114.6

China

China's current-account and trade surpluses are both forecast to fall to modest levels as a proportion of GDP in the forecast period, and so the country will be in a strong position to resist external pressure to allow a faster rate of currency appreciation. Indeed, with the currency now probably close to market-driven levels, more volatility in the value of the renminbi is likely in 2012-16, including periodic bouts of depreciation. Overall, however, we believe that the renminbi will strengthen against the US dollar, by an average of 2.7% a year, in 2012-16, slower than the rate of 4.8% appreciation recorded in 2011. This partly reflects higher productivity growth in China than in the US. A faster rate of inflation in China than in OECD markets will also help to rebalance the real exchange rate.

China

	2011	2012	2013	2014	2015
Rmb:US$ (av)	6.5	6.3	6.1	5.9	5.9
Nominal appreciation of Rmb (%)	4.8	3.3	2.6	3.3	0.8
Real appreciation of Rmb (%)	7.7	4.6	4.7	4.6	1.8
Rmb:US$ (end period)	6.3	6.2	6.0	5.9	5.8
Rmb:€ (av)	9.0	8.2	7.9	7.5	7.3
Nominal appreciation of Rmb (%)	0.3	9.6	4.2	4.9	3.2
Real appreciation of Rmb (%)	3.1	11.3	7.4	7.1	5.1
Rmb:€ (end period)	8.4	8.0	7.7	7.4	7.3
Rmb:¥100 (av)	5.9	5.8	5.7	5.6	5.6
Nominal appreciation of Rmb (%)	-1.7	2.1	1.2	2.3	-0.2
Real appreciation of Rmb (%)	3.8	5.8	5.5	5.8	2.5
Rmb:¥100 (end period)	5.8	5.8	5.7	5.7	5.6
Real effective exchange rate (1997=100)	94.8	92.3	91.8	93.2	97.0

Hong Kong

The Hong Kong Monetary Authority (HKMA, which performs some of the functions of a central bank) has repeatedly reaffirmed its commitment to maintaining the Hong Kong dollar's peg to the US dollar, and no change to this policy is expected in the next five years. We assume that Hong Kong's large foreign-exchange reserves, supplemented by its substantial fiscal reserves and its current-account surplus, will enable the HKMA to resist pressure to alter its exchange-rate policy. Given the potential for volatility in global financial and foreign-exchange markets in the next two years, the currency peg will remain an important source of economic stability in the territory. There will nevertheless be increasing discussion of the options for moving away from the US dollar peg towards a closer link to China's renminbi, perhaps via a peg to a basket of currencies,

Hong Kong

	2011	2012	2013	2014	2015
HK$:US$ (av)	7.8	7.8	7.8	7.8	7.8
Nominal appreciation of HK$ (%)	-0.2	-0.2	0.0	0.0	0.0
Real appreciation of HK$ (%)	2.4	0.9	0.0	0.3	0.5
HK$:US$ (end period)	7.8	7.8	7.8	7.8	7.8
HK$:€ (av)	10.8	10.2	10.1	9.9	9.7
Nominal appreciation of HK$ (%)	-4.5	5.9	1.6	1.6	2.4
Real appreciation of HK$ (%)	-2.0	7.3	2.5	2.7	3.7
HK$:€ (end period)	10.3	10.1	10.1	9.8	9.8
HK$:¥100 (av)	7.2	7.3	7.4	7.4	7.5
Nominal appreciation of HK$ (%)	-6.4	-1.3	-1.4	-0.9	-1.0
Real appreciation of HK$ (%)	-1.4	2.0	0.8	1.4	1.1
HK$:¥100 (end period)	7.2	7.3	7.4	7.5	7.5
Real effective exchange rate (1997=100)	89.7	84.8	81.6	79.5	75.8

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as is used in Singapore. The timing of such a move (which will not occur during 2012-16) would depend on how quickly China opens its capital account.

India

The rupee is forecast to depreciate in the short term, from an average of Rs46.7:US$1 in 2011 to Rs50.9:US$1 in 2012. India's widening trade and fiscal deficits have put pressure on the rupee, Asia's worst-performing currency last year, which traded at an all-time low of around Rs53:US$1 in December before recovering to an average of Rs51.3:US$1 in January 2012. In the remainder of the forecast period we expect the local currency to appreciate modestly, reaching Rs46.1:US$1 in 2016, bolstered by inflows of foreign investment attracted by India's bright economic prospects.

Indonesia

The rupiah appreciated by 3.6% against the US dollar on an annual average basis in 2011, taking its cumulative appreciation since 2009 to 18.5%. The local currency has been supported by relatively rapid GDP growth and interest from foreign investors in carry trades (whereby speculators borrow in countries where interest rates are low, such as the US and Japan, to purchase assets in countries with higher rates, such as Indonesia). The rupiah will remain vulnerable to sudden swings in sentiment, but the currency is likely to be supported by a wide differential between local interest rates and those in advanced economies, at least until 2013. Thereafter, Indonesia's relatively rapid GDP growth and its current-account surplus will boost the local currency. After depreciating by 2.1% in 2012 and 0.2% in 2013, the rupiah will appreciate by 1.1% a year in 2014-16.

Japan

The yen has remained very strong in the past few months, and stood at around ¥78:US$1 in mid-February. The rapid appreciation of the Japanese currency against the US dollar between April 2011 (when it hit ¥85:US$1) and late October (when it reached ¥75.7:US$1) owed much to its safe-haven status, amid turmoil in global financial markets stemming from concerns about the health of public finances in the euro zone and signs that global economic growth was slowing. The strong yen is leading to a loss of export-competitiveness. In late October the Ministry of Finance intervened in the market by selling yen, and there are signs that there have since been further, less overt, yen sales that have allowed the currency to weaken a little. We therefore estimate the exchange rate of the yen against the US dollar at an average of ¥78.1:US$1 in 2012, representing a strengthening from ¥79.8:US$1 in 2011, as the local currency continues to receive support from Japan's current-account surplus and plentiful foreign-exchange reserves. The interest rate differential between Japan and the US is likely to remain negligible in the next 18-24 months, as the Federal Reserve (the US central bank) is expected to keep its funds rates at 0¬0.25% until the second half of 2013, while Japan's main policy rate, the overnight call rate, will remain close to 0%. Low interest rates in Japan will continue to encourage the carry trade (whereby investors borrow in currencies subject to low interest rates and lend in currencies

continued on page 12

India

	2011	2012	2013	2014	2015
Rs:US$ (av)	46.7	50.9	50.5	48.4	47.2
Nominal appreciation of Rs (%)	-2.0	-8.4	0.8	4.4	2.6
Real appreciation of Rs (%)	3.9	-3.3	5.8	9.6	7.3
Rs:US$ (end period)	53.3	50.7	49.4	47.8	46.6
Rs:€ (av)	64.9	66.7	65.2	61.4	58.5
Nominal appreciation of Rs (%)	-6.3	-2.8	2.4	6.1	5.0
Real appreciation of Rs (%)	-0.5	2.9	8.5	12.2	10.7
Rs:€ (end period)	70.8	65.4	63.8	59.7	58.7
Rs:¥100 (av)	42.9	47.4	47.7	46.1	45.3
Nominal appreciation of Rs (%)	-8.1	-9.4	-0.6	3.5	1.6
Real appreciation of Rs (%)	0.1	-2.2	6.6	10.8	7.9
Rs:¥100 (end period)	49.1	47.6	46.9	45.7	44.8
Real effective exchange rate (1997=100)	105.6	105.3	109.5	109.5	119.8

Indonesia

	2011	2012	2013	2014	2015
Rp:US$ (av)	8,770	8,958	8,976	8,959	8,803
Nominal appreciation of Rp (%)	3.6	-2.1	-0.2	0.2	1.8
Real appreciation of Rp (%)	6.4	0.5	3.0	3.1	5.1
Rp:US$ (end period)	9,068	8,892	8,968	8,881	8,751
Rp:€ (av)	12,191	11,735	11,580	11,377	10,916
Nominal appreciation of Rp (%)	-0.8	3.9	1.3	1.8	4.2
Real appreciation of Rp (%)	1.8	6.9	5.6	5.5	8.5
Rp:€ (end period)	12,060	11,471	11,568	11,101	11,026
Rp:¥100 (av)	8,067	8,333	8,468	8,532	8,465
Nominal appreciation of Rp (%)	-2.8	-3.2	-1.6	-0.7	0.8
Real appreciation of Rp (%)	2.5	1.6	3.7	4.2	5.7
Rp:¥100 (end period)	8,358	8,350	8,500	8,498	8,414
Real effective exchange rate (1997=100)	87.6	83.4	82.6	96.4	96.5

Japan

	2011	2012	2013	2014	2015
¥:US$ (av)	79.8	78.1	80.9	81.0	82.0
Nominal appreciation of ¥ (%)	10.0	2.2	-3.5	-0.1	-1.2
Real appreciation of ¥ (%)	6.9	-0.5	-6.0	-2.5	-3.1
¥:US$ (end period)	77.7	80.5	80.2	82.0	82.5
¥:€ (av)	110.9	102.3	104.4	102.9	101.7
Nominal appreciation of ¥ (%)	5.2	8.5	-2.0	1.5	1.2
Real appreciation of ¥ (%)	2.3	5.9	-3.6	-0.2	0.1
¥:€ (end period)	103.4	103.8	103.4	102.5	104.0
¥:¥100 (av)	73.4	72.6	76.3	77.1	78.8
Nominal appreciation of ¥ (%)	3.2	1.1	-4.9	-1.0	-2.2
Real appreciation of ¥ (%)	3.0	0.6	-5.3	-1.4	-2.5
¥:¥100 (end period)	71.6	75.6	76.0	78.5	79.3
Real effective exchange rate (1997=100)	98.0	99.0	92.9	83.7	77.3

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***Foreign Exchange Rates*, from page 11**

attracting higher ones, profiting from the difference), and this should act as a moderating influence on the strength of the yen. The currency is expected to display a weakening trend against the US dollar in 2013¬16 as American interest rates rise more quickly than those in Japan.

New Zealand

We expect the New Zealand dollar to depreciate gradually during the forecast period, from an annual average of NZ$1.34:US$1 in 2012 to NZ$1.49:US$1 in 2016. Our benign forecast is based on the assumption that the local currency will remain popular with investors: even amid the recent bout of volatility in global financial markets, its value has held up well. However, the New Zealand dollar's vulnerability to fluctuations in international investor risk appetite and global interest rates mean that it could be more volatile than expected in the forecast period.

New Zealand

	2011	2012	2013	2014	2015
NZ$:US$ (av)	1.27	1.34	1.42	1.46	1.49
Nominal appreciation of NZ$ (%)	9.6	-5.5	-5.8	-2.7	-1.5
Real appreciation of NZ$ (%)	11.1	-5.7	-6.2	-3.5	-2.3
NZ$:US$ (end period)	1.30	1.37	1.46	1.46	1.49
NZ$:€ (av)	1.76	1.76	1.84	1.86	1.84
Nominal appreciation of NZ$ (%)	4.9	0.2	-4.3	-1.2	0.9
Real appreciation of NZ$ (%)	6.3	0.3	-3.9	-1.2	0.8
NZ$:€ (end period)	1.72	1.77	1.88	1.83	1.88
NZ$:¥100 (av)	1.16	1.25	1.34	1.39	1.43
Nominal appreciation of NZ$ (%)	2.8	-6.6	-7.1	-3.7	-2.5
Real appreciation of NZ$ (%)	7.0	-4.6	-5.6	-2.4	-1.7
NZ$:¥100 (end period)	1.19	1.29	1.38	1.40	1.43
Real effective exchange rate (1997=100)	92.3	98.6	104.0	96.3	102.6

Philippines

	2011	2012	2013	2014	2015
PhP:US$ (av)	43.3	43.0	43.5	43.7	43.5
Nominal appreciation of PhP (%)	4.1	0.7	-1.1	-0.5	0.5
Real appreciation of PhP (%)	6.3	1.8	0.7	1.2	2.3
PhP:US$ (end period)	43.9	43.3	43.6	43.6	43.4
PhP:€ (av)	60.2	56.4	56.1	55.5	53.9
Nominal appreciation of PhP (%)	-0.3	6.8	0.4	1.1	2.9
Real appreciation of PhP (%)	1.8	8.3	3.3	3.6	5.6
PhP:€ (end period)	58.4	55.8	56.2	54.5	54.7
PhP:¥100 (av)	39.8	40.0	41.0	41.6	41.8
Nominal appreciation of PhP (%)	-2.3	-0.5	-2.5	-1.4	-0.5
Real appreciation of PhP (%)	2.4	3.0	1.5	2.3	2.9
PhP:¥100 (end period)	40.5	40.6	41.3	41.7	41.7
Real effective exchange rate (1997=100)	69.2	67.0	71.5	79.1	85.5

Singapore

	2011	2012	2013	2014	2015
S$:US$ (av)	1.26	1.23	1.22	1.20	1.18
Nominal appreciation of S$ (%)	8.4	2.1	1.3	1.6	1.7
Real appreciation of S$ (%)	11.2	3.6	1.9	1.2	1.0
S$:US$ (end period)	1.30	1.21	1.21	1.19	1.16
S$:€ (av)	1.75	1.61	1.57	1.52	1.46
Nominal appreciation of S$ (%)	3.7	8.3	2.9	3.2	4.2
Real appreciation of S$ (%)	6.4	10.3	4.5	3.6	4.3
S$:€ (end period)	1.73	1.57	1.56	1.48	1.47
S$:¥100 (av)	1.16	1.15	1.15	1.14	1.13
Nominal appreciation of S$ (%)	1.7	1.0	-0.1	0.7	0.8
Real appreciation of S$ (%)	7.1	4.8	2.7	2.4	1.7
S$:¥100 (end period)	1.20	1.14	1.14	1.14	1.12
Real effective exchange rate (1997=100)	85.7	84.5	83.3	84.5	84.5

Philippines

We expect the Philippine peso to appreciate by an annual average of only 0.7% against the US dollar this year, after strengthening by 5.7% in 2010 and 4.1% in 2011. Capital inflows have supported the currency in the past two years: the Philippines attracted short-term portfolio inflows totaling around US$15bn in 2010-11, exceeding combined inflows in the nine previous years. But, as a result of increased global risk aversion, portfolio inflows are likely to fall in 2012. The peso will depreciate slightly in 2013-14, as central banks in the developed world begin to tighten monetary policy, thereby making Philippine yields relatively less attractive. But strong GDP growth, together with the Philippines' continued current-account surplus, will support the currency. The peso will resume its appreciation in 2015-16. There is, however, a downside risk to this forecast: the peso would be vulnerable were global risk aversion to increase more sharply than we expect, for example in response to a debt default in the euro zone.

Singapore

Despite the recent loosening of monetary policy, the central bank is still supporting a steady appreciation of the local currency, and we therefore expect it to gain further ground against the US dollar this year. Although it weakened slightly against the US dollar in the final months of 2011, the Singapore dollar's value remained high over the year as a whole, averaging S$1.26:US$1, compared with S$1.36:US$1 in 2010. In line with the MAS's policy objective, we expect the Singapore dollar to strengthen gradually, to an average of S$1.23:US$1, in 2012. Assuming that inflationary pressures dissipate from the second half of the year, the authorities will attempt to bolster the city state's international competitiveness by slowing the currency's appreciation against the US dollar and the euro. The Singapore dollar will remain relatively strong during the remainder of the forecast period, averaging S$1.15:US$1 in 2016. However, management of the exchange rate could be complicated by factors influencing the values of other currencies. Imbalances in the US and European economies could also lead to periods of turbulence for the US dollar and the euro, in turn giving rise to volatility in Asian currency markets.

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South Korea

Despite the authorities' move in 2010 to reimpose taxes on interest and capital gains on South Korean government bonds owned by non-residents, which (along with several other measures) was designed to curb destabilizing capital flows, the won remains vulnerable to sudden shifts in value. Our core forecast is that the won will appreciate in the forecast period, from an annual average of W1,125: US$1 in 2012 to W1,035:US$1 in 2016, reflecting the economy's steady productivity gains and the strength of the current-account position. However, although the government may take further measures to make flows on the capital account stickier, the country's financial markets will remain among the most open in Asia, meaning that exchange-rate volatility could be high, especially if global foreign-exchange markets remain unstable. Notably, elevated tensions with North Korea could put downward pressure on the won's value.

Thailand

Following rises in its value of 8.2% in 2010 and 3.9% in 2011, the baht will depreciate by 2.6% against the US dollar on an annual average basis in 2012, partly reflecting the current-account deficit that is forecast this year. In 2013-16 the baht will strengthen by 0.7% a year on average, driven mainly by inflows of short-term portfolio capital attracted by the Thai economy's relatively rapid pace of expansion. The country's strong economic fundamentals and the return of the current account to surplus from next year will also provide support to the baht. The Bank of Thailand (the central bank) will intervene in the currency markets to prevent exchange-rate volatility and may introduce further measures to deter currency speculation, but it is not expected to attempt to reverse a market-driven rising trend in the baht. The local currency will remain vulnerable to sudden swings in sentiment towards emerging markets, as occurred in September 2011, when the baht weakened by 3.7% against the US dollar in a single month owing to concerns generated by the debt crisis in the euro zone.

Vietnam

In reaction to strong downward pressure on the dong, the SBV devalued the local currency on four occasions between November 2009 and February 2011, resulting in a cumulative drop of almost 13% in its value against the US dollar. Vietnam's meager foreign-exchange reserves mean that the central bank will not be able to counteract downward pressure by intervening in the currency markets. The latest published data show that foreign reserves stood at just US$13.5bn in May 2011, representing less than two months of import cover, down from a high of US$26.4bn in March 2008. The smaller current-account deficit in 2012 will provide some support to the local currency in 2012, but we still believe that the dong will drift lower over the course of the year as the persistence of inflation saps confidence in the currency. As inflation falls and exports expand strongly, the currency will perform slightly better in 2013-14—weakening, but at a slower pace than in recent years. However, the pace of depreciation will pick up later in the forecast period as concerns about the expanding trade deficit increase. ❑

South Korea

	2011	2012	2013	2014	2015
W:US$ (av)	1,108	1,125	1,106	1,090	1,041
Nominal appreciation of W (%)	4.3	-1.5	1.8	1.4	4.7
Real appreciation of W (%)	5.7	-1.1	1.9	1.6	4.8
W:US$ (end period)	1,153	1,115	1,098	1,066	1,038
W:€ (av)	1,540	1,474	1,426	1,384	1,291
Nominal appreciation of W (%)	-0.2	4.5	3.3	3.0	7.2
Real appreciation of W (%)	1.2	5.2	4.5	4.0	8.2
W:€ (end period)	1,534	1,439	1,416	1,332	1,308
W:¥100 (av)	1,019	1,047	1,043	1,038	1,001
Nominal appreciation of W (%)	-2.2	-2.6	0.3	0.5	3.7
Real appreciation of W (%)	1.9	0.0	2.6	2.7	5.4
W:¥100 (end period)	1,063	1,047	1,041	1,020	998
Real effective exchange rate (1997=100)	76.5	77.6	85.9	90.2	90.2

Thailand

	2011	2012	2013	2014	2015
Bt:US$ (av)	30.5	31.3	30.9	30.7	30.6
Nominal appreciation of Bt (%)	3.9	-2.6	1.3	0.6	0.4
Real appreciation of Bt (%)	5.1	-2.1	1.7	1.0	1.2
Bt:US$ (end period)	31.7	31.1	30.8	30.7	30.5
Bt:€ (av)	42.4	41.0	39.9	39.0	37.9
Nominal appreciation of Bt (%)	-0.6	3.3	2.9	2.1	2.8
Real appreciation of Bt (%)	0.6	4.1	4.3	3.4	4.5
Bt:€ (end period)	42.1	40.1	39.7	38.3	38.4
Bt:¥100 (av)	28.0	29.1	29.1	29.3	29.4
Nominal appreciation of Bt (%)	-2.5	-3.7	-0.1	-0.4	-0.5
Real appreciation of Bt (%)	1.3	-1.0	2.5	2.2	1.8
Bt:¥100 (end period)	29.2	29.2	29.2	29.3	29.3
Real effective exchange rate (1997=100)	84.8	84.6	86.2	93.1	98.7

Vietnam

	2011	2012	2013	2014	2015
D:US$ (av)	20,649	21,705	22,481	22,934	23,589
Nominal appreciation of D (%)	-7.4	-4.9	-3.5	-2.0	-2.8
Real appreciation of D (%)	7.1	6.5	2.7	2.3	2.1
D:US$ (end period)	21,024	22,089	22,707	23,261	24,102
D:€ (av)	28,702	28,434	29,000	29,126	29,250
Nominal appreciation of D (%)	-11.4	0.9	-2.0	-0.4	-0.4
Real appreciation of D (%)	2.5	13.3	5.3	4.7	5.4
D:€ (end period)	27,961	28,495	29,293	29,077	30,369
D:¥100 (av)	18,992	20,191	21,208	21,842	22,681
Nominal appreciation of D (%)	-13.1	-5.9	-4.8	-2.9	-3.7
Real appreciation of D (%)	3.2	7.7	3.5	3.4	2.7
D:¥100 (end period)	19,376	20,741	21,524	22,260	23,175
Real effective exchange rate (1997=100)	87.6	86.8	90.6	93.3	93.9

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Foreign Exchange

Pacific Exchange Rate Services Exchange Rates for the Dollar as of April 11, 2012

The table below gives the rates of exchange for the U.S. dollar against various currencies as of April 11, 2012. All currencies are quoted in foreign currency units per U.S. dollar except in certain specified areas. All rates quoted are indicative. They are not intended to be used as a basis for particular transactions. Pacific Exchange Rate Services (http://pacific.commerce.ubc.ca) does not assume responsibility for errors.

	Currency	Value of U.S. Dollar	Country	Currency	Value of U.S. Dollar	Country	Currency	Value of U.S. Dollar
Afghanistan	Afghani	49.87	Georgia	Lari	1.636	Norfolk Islands	Aus. Dollar	0.9703
Albania	Lek	106.31	Germany	Euro*	1.3136	Norway	Krone	5.7929
Algeria	Dinar	74.929	Ghana	Cedi	1.795	Oman Sultanate	Rial	0.385
Andorra	Euro*	1.3136	Gibraltar	Br. Pound*	1.5912	Pakistan	Rupee	90.724
Angola	Kwanza	93.19	Greece	Euro*	1.3136	Panama	Balboa	1.00
Antigua	E.Car. $	2.7	Greenland	Dan. Krone	5.6608	Papua N.G.	Kina	2.0481
Argentina	Peso	4.383	Grenada	E.Car. $	2.7	Paraguay	Guarani	4335.00
Armenia	Dram	391.65	Guadeloupe	Euro*	1.3136	Peru	Nuevo Sol	2.6675
Aruba	Guilder	1.79	Guam	US$	1.00	Philippines	Peso	42.74
Australia	Dollar	0.9703	Guatemala	Quetzal	7.7	Pitcairn Island	NZ Dollar	1.22
Austria	Euro*	1.3136	Guinea Republic	Franc	7070.00	Poland	Zloty	3.1925
Azerbaijan (new)	Manat	0.76	Guinea Bissau	CFA Franc	500.50	Portugal	Euro*	1.3136
Azores	Euro*	1.3136	Guyana	Dollar	201.50	Puerto Rico	US$	1.00
Bahamas	Dollar	1.00	Haiti	Gourde	41.011	Qatar	Riyal	3.6408
Bahrain	Dinar	0.377	Heard/McDonald Is.	Aus. Dollar	0.9703	Rep. Yemen	Rial	209.29
Bangladesh	Taka	82.025	Honduras	Lempira	19.06	le de la Reunion	Euro*	1.3136
Barbados	Dollar	2.00	Hong Kong	Dollar	7.7648	Romania	Leu	3.3292
Belarus	Ruble	8090.00	Hungary	Forint	226.76	Russia	Ruble	29.674
Belgium	Euro*	1.3136	Iceland	Krona	127.25	Rwanda	Franc	606.77
Belize	Dollar	1.9135	India	Rupee	51.425	Samoa (American)	US$	1.00
Benin	CFA Franc	500.50	Indonesia	Rupiah	9173.10	San Marino	Euro*	1.3136
Bermuda	Dollar	1.00	Iran	Rial	12262.00	Sao Tome/Principe	Dobra	19000.00
Bhutan	Nguitrum	51.425	Iraq	Dinar	1165.00	Saudi Arabia	Riyal	3.7502
Bolivia	Boliviano	6.910	Ireland	Euro*	1.3136	Senegal	CFA Franc	500.50
Bosnia Herzegovina	Konv. Marka	1.380	Israel	New Shekel	3.7536	Serbia/Montenegro	Yug. N. Dinar	84.92
Botswana	Pula	7.4543	Italy	Euro*	1.3136	Seychelles	Rupee	14.075
Bouvet Island	Krone	N/A	Jamaica	Dollar	86.775	Sierra Leone	Leone	4351.30
Brazil	Real	1.8312	Japan	Yen	80.897	Singapore	Dollar	1.258
Brunei	Dollar	1.2578	Johnston Island	US$	1.00	Slovakia	Koruna	22.936
Bulgaria	Lev	1.4886	Jordan	Dinar	0.7087	Slovenia	Tolar	N/A
Burkina Faso	CFA Franc	500.50	Kazakhstan	Tenge	147.75	Solomon Is.	Solomon$	7.0793
Burundi	Franc	1395.30	Kenya	Shilling	83.3	Somali Rep.	Shilling	1625.00
Cameroun	CFA Franc	500.50	Kiribati	Aus. Dollar	0.9703	South Africa	Rand	7.9871
Canada	Dollar	1.0022	Korea, North	Won	118.18	Spain	Euro*	1.3136
Cape Verde Islands	Escudo	83.93	Korea, South	Won	1144.50	Sir Lanka	Rupee	127.75
Cayman Islands	Dollar	0.82	Kuwait	Dinar	0.2782	St. Helena	Br. Pound*	1.5912
Cent. Af. Republic	CFA Franc	500.50	Kyrgyzstan	Som	46.75	St. Kitts	E. Car. $	2.7
Chad	CFA Franc	500.50	Laos	Kip	7999.00	St. Lucia	E. Car. $	2.7
Channel Islands	Br. Pound*	1.5912	Latvia	Lat	0.532	St. Pierre/Miq'lon	Euro*	1.3136
Chile	Peso	487.52	Lebanon	Pound	1503.00	St. Vincent	E. Car. $	2.7
China	Renminbi	6.3079	Lesotho	Maloti	7.9871	Sate of Cambodia	Riel	3995.00
Christmas Islands	Aus. Dollar	0.9703	Liberia	Dollar	73.50	Sudan	Dinar	N/A
Cocos Islands	Aus. Dollar	0.9703	Libya	Dinar	1.247	Suriname	Dollar	3.3
Colombia	Peso	1793.90	Liechtenstein	Sw. Franc	0.9143	Swaziland	Lilangeni	7.9871
Comoros Rep.	Franc	374.45	Lithuania	Litas	2.6278	Sweden	Krone	6.7751
Congo Republic	CFA Franc	500.50	Luxembourg	Euro*	1.3136	Switzerland	Franc	0.9143
Congo Dem Rep.	Franc	N/A	Macau	Pataca	7.9977	Syria	Pound	57.462
Costa Rica	Colon	508.74	Macedonia	Dinar	43.57	Taiwan	Dollar	29.538
Cote d'Ivoire	CFA Franc	500.50	Madagascar	Franc	8547.00	Tajikistan	Somoni	N/A
Croatia	Kuna	5.6854	Madeira	Euro*	1.3136	Tanzania	Shilling	1583.00
Cuba	Peso	1.00	Malawi	Kwacha	167.60	Thailand	Baht	30.89
Cyprus	Pound	0.4455	Malaysia	Ringgit	3.0807	Togo Rep.	CFA Franc	500.50
Czech Repub.	Koruna	18.877	Maldive Is.	Rufiyan	15.410	Tokelau	NZ $	1.22
Denmark	Krone	5.6608	Mali Republic	CFA Franc	500.50	Tonga Island	Pa'anga	1.57
Djibouti	Franc	177.72	Malta	Lira	0.326	Trinidad/Tobago	Dollar	6.3325
Dominica	E.Car. $	2.7	Martinique	Euro*	1.3136	Tunisia	Dinar	1.5193
Domi. Rep.	Peso	39.15	Mauretania	Ouguiya	291.75	Turkey	Lira	1.8047
Dronning Maud.	Nor. Krone	5.7929	Mauritius	Rupee	29.175	Turkmenistan (new)	Manat	2.79
East Timor	US$	1.00	Mexico	New Peso	13.126	Turks & Caicos	US$	1.00
Ecuador	US$	1.00	Moldova	Lei	11.81	Tuvalu	Aus. Dollar	0.9703
Egypt	Pound	6.0414	Monaco	Euro*	1.3136	Uganda	Shilling	2510.00
El Salvador	Colon	8.7475	Mongolia	Tugrik	1310.50	Ukraine	Hryvnia	8.0205
Eq'tl Guinea	CFA Franc	500.50	Montserrat	E.Car. $	2.7	United Kingdom	Br. Pound*	1.5912
Eritrea	Nafka	13.63	Morocco	Dirham	8.4876	Uruguay	Peso	19.52
Estonia	Kroon	11.912	Mozambique (new)	Metical	25.70	U.A.E.	Dirhan	3.673
Ethiopia	Birr	17.503	Myanmar	Kyat	822.16	Uzbekhistan	Som	1849.80
European EMU	Euro*	1.3136	Namibia	Dollar	7.4	Vanuatu	Vatu	94.2
Faeroe Islands	Dan. Krone	5.6608	Nauru Is.	Aus. Dollar	0.9703	Vatican City	Euro*	1.3136
Falkland Islands	Br. Pound*	1.5912	Nepal	Rupee	82.30	Venezuela	Bolivar	4.29
Fiji	Dollar	1.7902	Neth. Antilles	Guilder	1.79	Vietnam	Dong	20825.00
Finland	Euro*	1.3136	Netherlands	Euro*	1.3136	Virgin Islands BR	US$	1.00
Fr. Pacific Islands	Franc	90.684	New Zealand	Dollar	1.22	Virgin Islands US	US$	1.00
France	Euro*	1.3136	Nicaragua	Cordoba	23.295	West Samoa	Tala	2.04
French Guiana	Euro*	1.3136	Nieue	NZ Dollar	1.22	Zambia	Kwacha	5263.80
Gabon	CFA Franc	500.50	Niger Rep.	CFA Franc	500.50	Zimbabwe	Dollar	N/A
Gambia	Dalasi	29.700	Nigeria	Naira	157.67			

(N/A) Not Available * U.S. Dollar per national currency unit

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suddenly being paraded around in the tax-equivalent of a head-snapping string bikini.

The ESD came naked into this world as just one of many synonymous-sounding anti-abuse doctrines[4] developed by the courts over the years to deny tax benefits in situations that courts found to be abusive, tax-motivated transactions. The ESD was most famously articulated in a U.S. Supreme Court case, *Frank Lyon v. Commissioner*,[5] and after *Lyon* the lower courts developed the ESD further, but disagreed over its specific technical applications. Most courts agreed that there was a two-prong test, comprised of 1) whether the transaction had economic substance (the "objective" test) and 2) whether there was a non-tax business purpose (the "subjective" test). However, the courts split into three camps over how to apply the test, with some courts requiring that both prongs be met (a conjunctive test), some courts requiring that either prong be met (a disjunctive test), and some courts taking both tests into account in reaching an ultimate determination (a combined test).

The Congress, in codifying the ESD, opted to apply the conjunctive test, with a huge dollop of enforcement penalties ladled on top. New Section 7701(o) reads in relevant part as follows:

Clarification of Economic Substance Doctrine
Application of Doctrine

In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.[6]

If the language of Section 7701(o) is generally vague, there is one prominent exception: the penalties. The ESD is accompanied by a clearly written and truly scary new penalty provision, set forth in Section 6662(b)(6), which applies "strict liability" (meaning that there is no good faith exception) to any transaction that lacks economic substance under Section 7701(o) or under "any similar rule of law." The penalty is 40 percent if the transaction is undisclosed, and is 20 percent even if the transaction is adequately disclosed, with further disclosure requirements for a reportable transaction.

An obvious and immediate short-coming of the ESD statute is that it does not make any effort to identify the transactions to which it will be applied. Rather, it merely provides that, if the ESD is *"relevant,"* then the conjunctive test applies. The erstwhile legislative history (technically the Joint Committee Report[7] or "Bluebook") to Section 7701(o) gives at least some guidance on the intended scope, but most of this is in the form of platitudes, together with a few examples, most of which fall into the "no brainer" category.

The problem is that the Economic Substance Doctrine is exceedingly difficult to define.

The Bluebook explanation of the provision starts with the broad homily that "the provision does not change present law standards in determining when to utilize an economic substance analysis,"[8] followed by the bromide in the related footnote that "[i]f the realization of the tax benefits of a transaction is consistent with the Congressional purpose or plan that the tax benefits were designed by Congress to effectuate, it is not intended that such tax benefits be disallowed."[9] (This astonishingly casual and off-hand comment will be taken at face value by this article—indeed, will be given more concrete importance than it may in fact deserve—and will hereinafter be referred to as the "Congressional Plan" exception.)

The Bluebook then tosses out a second platitude, which is that the ESD is "not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages."[10] (This similarly flip and after-hours standard will be referred to hereinafter as the "Basic Business Transaction" exception.) The Bluebook then provides four "safe" examples of an exempt Basic Business Transaction (herein referred to collectively as the "Angel Transactions"), comprised of the following[11]:

1. the choice between capitalizing a business enterprise with debt or equity ("First Angel Transaction");
2. a U.S. person's choice between using a foreign corporation or domestic corporation to make a foreign investment ("Second Angel Transaction");

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3. the choice to enter into a transaction or series of transactions that constitute a corporate organization or reorganization under Subchapter C ("Third Angel Transaction"); and
4. the choice to utilize a related-party entity in a transaction, provided that the parties act consistently with the arms-length standards contained in Section 482 ("Forth Angel Transaction").

Don't Ask, Won't Tell

The IRS soon followed up the codification of the ESD with what can properly be characterized as a comedy of non-guidance. First, the IRS issued Notice 2010-62, announcing its intention neither to provide a black list nor an angel list of transactions, while notifying taxpayers that the subject was also outside the scope of private letter ruling requests. In other words, a "Don't Ask, Won't Tell" policy. However, the ESD inspired far too much interest, fascination and fear to slip quietly into the night, and so, when the IRS subsequently issued two relatively boring and technical documents known as "field directives," on September 14, 2010[12] (2010 Directive) and July 15, 2011[13] (2011 Directive), these two documents were eagerly seized upon for guidance with the enthusiasm of paparazzi studying a sensational new Paris Hilton naked video tape. (You're kidding! The IRS did WHAT?!!)

The penalty is 40 percent if the transaction is undisclosed, and 20 percent even if the transaction is adequately disclosed.

The IRS apparently forgot that it is the most closely watched and enthusiastically scrutinized branch of the entire federal government—the Lindsay Lohan of bureaucracies. In any event, the IRS was so disconcerted by the tabloid, National Enquirer-like response to the 2011 Directive that, on October 6, 2011, an IRS official speaking on the record at a tax luncheon made it clear that the 2011 Directive was "just that" (i.e., a field directive and nothing more), and thus did not create any new substantive law or otherwise provide any precedent that could be relied on by taxpayers.[14] In other words, the IRS basically announced, "We didn't tell you what we just told you, so please ignore everything you just read." And just how logical and successful a response was that to the IRS's own self-inflicted controversy?

Don't ask.

What's It All About, Alfie?

So, after all that, what kind of international tax transactions are most likely to fall under the Economic Substance Doctrine? Traditionally—meaning based on the types of litigated tax-controversy cases that created the ESD doctrine in the first place—the "classic" targets should be technically complex, often multi-tiered financial transactions, usually undertaken by very large companies and for relatively blatant tax-avoidance motivations. If we take Congress at its word, the ESD ought not impact the common, traditional forms of tax structuring, including international tax structuring.

However, a nagging concern among tax advisors is that international tax structuring, even more so than domestic tax planning, is often driven *entirely* by tax-planning considerations. For example, the use of Dutch CVs, or Bermuda holding companies, or "double Irish" structures, or Cyprus holding companies, or any number of other common international business arrangements, are implemented precisely (and, in many cases, entirely) because they produce favorable international tax consequences.

On the other hand, these international transactional structures are implemented precisely because they comport with the letter of the tax law, and arguably with its spirit as well. The Bluebook states that the ESD is not intended to disrupt the tax benefits of a transaction that "is consistent with the Congressional purpose or plan that the tax benefits were designed by Congress to effectuate," i.e., the "Congressional Plan" exception. Likewise, the Bluebook states that the ESD is not intended to apply to "basic business transactions that, under longstanding judicial and administrative practice are respected…" i.e., the "Basic Business Transactions" exception. With these basic principles in mind, and having read and NOT ignored the 2010 and 2011 Directives, let's look at a few relatively common international transactions and consider how the ECD might be—and, dare we suggest, ought to be—applied under Section 7701(o).

Hypothetical #1: Sale of Non-U.S. Software Rights to a Foreign Subsidiary

A. Structure of the Transaction(s)

1. USCo has developed a new and valuable software program (Software) that it wishes to exploit both within and outside the U.S. To conduct its non-U.S. activities, USCo creates a wholly-owned subsidiary under the laws of Ireland, managed and controlled in Bermuda (IPSub).

2. USCo sells the non-U.S. rights in the Software (the Non-U.S. Rights) to IPSub for an arms-length purchase price that meets the requirements of Section 482 and the applicable regulations. USCo and IPSub then enter into a cost-sharing agreement, pursuant to which the two parties will continue to develop and upgrade the Software, and will share the costs in a manner that complies with the applicable regulations under Reg. Section 1482-7.

3. IPSub, in turn, creates a wholly owned subsidiary, which is an "eligible entity" formed under the laws of Ireland, and managed, controlled and operating in Ireland (Licensing Sub).

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4. IPSub licenses the Non-U.S. Rights to Licensing Sub, which in turn uses the Software to conduct a bona fide licensing business in Ireland that is intended to meet the requirements of Section 954(c)(2)(A).[15]

5. Licensing Sub, in turn, creates a substantial number of wholly owned subsidiaries, each an "eligible entity" formed under the laws of, and operating solely in, each jurisdiction where such Licensing Sub intents to exploit the Software (collectively, the Country Subs).

6. IP Sub elects[16] to "check-the-box" with respect to Licensing Sub and thereby causes Licensing Sub to be treated as a "disregarded entity" for U.S. federal income tax purposes. Licensing Sub, in turn, elects to "check-the-box" with respect to each Country Sub, and thereby causes each Country Sub to be treated as a disregarded entity for U.S. federal income tax purposes. The net effect of this check-the-box structure is that the IP Sub is treated for U.S. federal income-tax purposes as an Irish corporation carrying on business in Ireland and other jurisdictions, and engaged in a licensing business that meets the requirements of Section 954(c)(2)(A) and the applicable regulations.[17]

B. Discussion and Analysis under ESD

1. Migration of intellectual property to a foreign subsidiary is a historically common transaction for U.S.-based holding companies, and should easily come within the Basic Business Transaction exception in principle. For example, Section 367(d) addresses and provides a special rule for contributions of intangible property to a foreign subsidiary that overrides the general rule of Section 351, and such rule clearly anticipates that a transfer of IP to a foreign subsidiary is a generically permissible transaction. Literally thousands (a very conservative number) of U.S. corporations have transferred assets to a wholly owned foreign subsidiary over the years, often in connection with a cost-sharing agreement. In turn, forming a foreign subsidiary to receive investment funds, acquire the software, enter into the cost-sharing agreement, and then conduct foreign business activities is inherently condoned and approved in the Second Angel Transaction.

2. Sale of the Non-U.S. Rights to the IP Sub is inherently approved by the Fourth Angel Transaction, and further supported by the Second Angel Transaction. Furthermore, one can divine a Congressional Plan approving this element of the transaction from Sections 367 and 482 and the regulations thereunder, which expressly indicate that Section 367(d) does not apply in the case of an actual sale or license of intangible property by a U.S. person to a foreign corporation.[18] In turn, the cost-sharing agreement between the USCo and its IP Sub should be viewed as a Basic Business Transaction exempted by a history of acceptance and use over may years by the IRS, and also exempted by the Congressional Plan exception in light of the extensive regulations issued by the IRS over the years governing cost-sharing arrangements.[19]

If we take Congress at its word, the ESD ought not impact the common, traditional forms of tax structuring, including international tax structuring.

3. Formation of a second-tier foreign subsidiary by a first-tier foreign subsidiary should be accepted under the Basic Business Transaction rule, and also under the Second Angel Transaction. The Subpart F rules, for example, provide a specific exception under the definition of foreign base company sales income for purchases and sales of tangible property to related controlled foreign corporations formed under the laws of the country in which the tangible property is sold for use, consumption, or disposition,[20] and this statutory structure inherently assumes that bona fide foreign subsidiary business arrangements are respected, both under Subpart F in particular and under the Code in general.

4. A licensing arrangement at arms-length between IP Sub and Licensing Sub should come within the Fourth Angel Transaction and also, more generally, within the Basic Business Transaction exception.[21] Such arrangements have been around forever and there is no inherent tax abuse so long as the pricing meets the requirements of Section 482.[22]

5. The sub-licensing of the Non-U.S. Rights to Country Subs should be respected for the same reasons that are discussed in connection with Step 4 (Fourth Angel Transaction) and, more generally, Basic Business Transaction exception.

6. The election[23] to "check-the-box" for the entire foreign group should come within what I will describe (dare I use the term "invent") as a corollary of the Congressional Plan exception, which is that any *regulatory* scheme approved by the IRS in regulations or similar authoritative pronouncements that constitute "authority" for federal income tax purposes should be treated as a *de facto* safe harbor, so long as the structure is consistent with the regulatory intent. Here, the transaction involves the use of

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the "check-the-box" rules, which were issued by the IRS in 1997 as a resolution to the endless litigation under the *Kintner* Regulations.[24] The check-the-box regime has been used widely and repeatedly by U.S. holding companies in international business structures, and such use is well known by the IRS and is inherently approved by virtue of IRS silence on the matter. Indeed, the use of a check-the-box regime in connection with Subpart F issues is substantively consistent with the congressional policy contained in Section 954(c)(6), and thus has consistency with both regulatory and legislative policies directly pertaining to the structure and tax issues at hand. Ultimately, the Basic Business Transaction rule recognizes that there is an inherent "stare decisis" element to the codification of the ESD, which must necessarily accept and respect common and long-standing business transactional structures, and must look to the Congress for a change in the tax treatment of such structures.[25] In all events, such long-standing tolerance should not be subject to abrupt reversal, especially with an application of "strict liability" penalties, through a mere change in IRS enforcement policies.

The IRS followed up the codification of the ESD with what can properly be characterized as a comedy of non-guidance.

Hypothetical #2: Decision to Form a New Irish Corporation to Act as a Holding Company for all Foreign (Non-US) Operations

A. Transaction

1. USCo is a U.S. corporation, taxable as an S corporation, that in turn owns numerous first-tier foreign (non-U.S.) subsidiaries, each of which is formed under the laws of the applicable foreign jurisdiction in which it operates. Each foreign subsidiary carries on the business of acting as a sales agent for the USCo parent in the foreign subsidiary's jurisdiction of formation. USCo has historically engaged in the business of purchasing manufactured products from unrelated third-party manufacturers generally located in Asia, and then distributing these products in the United States and, through its subsidiaries, around the world. Under the current structure, USCo purchases all of the manufactured products directly in bulk, and then resells products in the U.S. and in each applicable foreign jurisdiction. The current structured is based on an "agency" model rather than a "distribution" model, meaning that each foreign subsidiary acts as a sales agent in its jurisdiction of formation, and earns a commission on such sales. This model was originally implemented as a tax-efficient "repatriation" structure, because almost all the income is taxed in the U.S. a single time at individual income tax rates of the USCo shareholders, and almost all of the money is brought back to the U.S. for use by USCo in its business operations. USCo does not currently check-the-box with respect to its foreign subsidiaries, but, as a practical matter, the foreign subsidiaries do not generate significant net income at this time, because the commissions paid on sales are largely offset by operating expenses in each applicable jurisdiction. USCo does not have meaningful use of its trademark or other intangibles in its foreign operations. A reasonably compelling argument can be made that any and all foreign customers are those generated by and belonging to the foreign subsidiaries.[26]

2. USCo has decided that the U.S. market is maturing, that U.S. income tax rates are excessive compared to those of other jurisdictions, and that it would be better off it if "trapped" its foreign-source income offshore, subject to lower tax rates, and then reinvested its offshore profits to develop its non-U.S. operations. USCo has therefore decided to form a new first-tier foreign holding company based in Ireland. USCo picked Ireland over Switzerland and Singapore (each of which has similarly low tax rates and favorable tax treaty networks) because its key administrative and management employees involved in international distribution activities were most willing to move to Ireland. The new Irish entity, IrishCo, will purchase and distribute products directly from the Asian manufacturers going forward, and will act as the foreign holding company for all non-U.S. business operations.

3. The USCo then contributes the stock of all of its existing first-tier foreign subsidiaries to IrishCo (thereby creating a controlled foreign corporation group or CFC Group). As part of the contribution transaction, USCo enters into a Gain Recognition Agreement, and takes all other steps to comply with the requirements of Section 367 and the related regulations. As a result, no income or gain is recognized on these contribution transactions.

4. IrishCo is a regarded entity for U.S. federal income tax purposes, actively engaged in business operations in Ireland. Meanwhile, a check-the-box election is made for all of the new second-tier foreign subsidiaries (i.e., the foreign corporations contributed by USCo to IrishCo) and these second-tier foreign subsidiaries are thereafter disregarded entities for U.S. federal income tax purposes.[27]

5. IrishCo thereafter purchases manufactured products from the unrelated Asian manufacturers,

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and sells these (through its disregarded subsidiaries) to unrelated parties throughout the world. Income is taxed throughout the CFC Group, but is primarily taxed to IrishCo at the moderate Irish tax rate of 12.5 percent. USCo continues to purchase products from the unrelated Asian manufacturers for distribution in the U.S., and pays U.S. income taxes on the income from the U.S. activities.

B. Discussion and Analysis under ESD

1. The pre-existing corporate structure is presumably "safe" because it is a relatively standard arrangement for a U.S. S corporation distributing products in Europe and throughout the world. Basic Business Transactions exception should apply. In all events, the IRS should have no beef because the starting structure is expressly designed to tax worldwide income right away in the U.S., and so the U.S. is getting far more tax revenue than is warranted by the actual operations. The Proposed Transaction, of course, is expressly designed to address and "fix" that problem!

2. The IrishCo is being formed because it has substantial business[28] and tax benefits. Tax benefits include low income tax rates compared to the U.S., and an extensive treaty network with countries in Europe and throughout the world. Forming a foreign subsidiary to conduct foreign business activities should be viewed as consistent with the Congressional Plan under Section 367, also should also be viewed as a Basic Business Transaction since it is within the scope—or at least the spirit—of the Second Angel Transaction.

3. The contribution of existing first-tier foreign subsidiaries to IrishCo to form the CFC Group is a transaction clearly anticipated by Section 367(a)(2), and thus part of the Congressional Plan, as well as a form of corporate reorganization that would be both a Basic Business Transaction and a Third Angel Transaction.

4. The election to "check-the-box" and treat as disregarded entities the members of the CFC Group below the IrishCo is merely a basic exercise of the regulatory scheme enacted by the IRS under Reg. § 301.7701-3 and widely used in international structures by U.S. taxpayers since 1997. Thus, as I noted above at footnote 23, it should be viewed as a corollary to the Congressional Plan exception.

5. The net tax effect of the USCo restructuring is that the income from non-U.S. sources that was largely subject to tax in the U.S. is instead subject to tax largely in Ireland, at much lower tax rates. There is nothing improper with this change in the tax consequences because the relevant business activities have actually been shifted to Ireland and are now substantively conducted through the Irish subsidiary (and its disregarded lower-tier subsidiaries) in non-U.S. jurisdictions. The business activity itself is not subject to the reach of Subpart F (it involves buying products from an unrelated party and selling them to an unrelated party, and thus does not generate Subpart F income[29]) and there is no reason why foreign source income from an active trade of business conducted entirely outside the U.S. should be subject to current U.S. tax. The fact that the U.S. corporation chose intentionally to make its foreign-source income immediately subject to U.S. taxation under the prior structure (i.e., arguably as a result of "dumb" tax planning) does not make the revised structure unfair or abusive in any way, and certainly would not merit an application of the ESD. Among other arguments one can advance—a little tongue-in-cheek, but nonetheless a factor in this relevant case—is that the ESD was designed to address and disallow aggressive tax-planning that is "too clever by half," and is specifically NOT intended to address a taxpayer whose business and tax structure is modified from "dumb" to "appropriate," and thereby merely results in a reduction of U.S. taxes.

Such long-standing tolerance by the IRS should not be subject to abrupt reversal, especially with an application of "strict liability" penalties.

A Naked Appeal for Common Sense

A fair question to ask is whether, even if each step in an international tax transactional structure is defensible under the ESD analysis set forth above, the transaction in the aggregate might nonetheless still be subject to IRS challenge, based on the argument that the overall transaction lacks economic substance. In particular, the IRS might argue that no one step is necessarily provocative or unseemly, but all the steps, taken together, cross the invisible line. In the movie business, after all, a bare breast here, a bare buttocks there, and pretty soon you have a film that even Potter Stewart would be interested in watching.

This article argues that a series of permissible transactional steps should add up to a permissible transaction in the whole under the ESD (and the tax equivalent of a "PG" rating), especially if the transaction involves international tax structuring, the goal is to create a rational business arrangement in light of complex international tax rules, and the transaction complies with the practical guidelines provided by the Joint Committee.

To be sure, if a tax transaction looks and feels like a bare effort at tax avoidance, a seductive scheme dressed up in a flimsy tax nothing, the IRS can and should give it the "X" rating it deserves. But those kinds of schemes, in the end, are as easy to spot as Lady Godiva on horse back: We *all* know them when we seen them.

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On the other hand, this article believes strongly—indeed, passionately—that there is an inherent admonishment to the IRS from Congress, embodied in the legislative history discussed above, that the ESD is not a racy and exotic new audit position for the IRS to assume. Rather, the IRS should invoke the ESD only discreetly and circumspectly, and always through a process governed by balance, respect for established practices, and above all common sense. ❑

1 Unless otherwise noted, all "Section" references are to the Internal Revenue Code of 1986, as amended.

2 The Health Care and Education Reconciliation Act of 2010, Public Law 111-50, Act Section 1409.

3 The ESD provides a conjunctive two-part test at Section 7701(o)(1)(A) and (B), both of which must be met in order to establish the existence of economic substance. Prior to this codification, federal courts were divided on whether a taxpayer needed to meet *both* prongs of the test or merely had to satisfy *either* prong of the test. Congress chose to stick taxpayers with a two-pronged fork.

4 The various court-invented doctrines include "business purpose," "sham transaction," "substance over form," "step transaction," and similar phraseology, all suggesting essentially the same problem and the same cure, which was to deny the tax benefits in cases where the transaction (or parts of the transaction) had no independent logic or purpose other than the generation of favorable tax benefits.

5 435 U.S. 561 (1978).

6 The Rest of Section 7701(o) reads as follows:

(2) Special rule where taxpayer relies on profit potential.

(A) In General. The potential for profit of a transaction shall be taken into account in determining whether the requirements of subparagraphs (A) and (B) of paragraph (1) are met with respect to the transaction only if the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.

(B) Treatment of Fees and Foreign Taxes. Fees and other transaction expenses shall be taken into account as expenses in determining pre-tax profit under subparagraph (A). The Secretary shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases.

(3) State and Local Tax Benefits. For purposes of paragraph (1), any State or local income tax effect which is related to a Federal income tax effect shall be treated in the same manner as a Federal income tax effect.

(4) Financial Accounting Benefits. For purposes of paragraph (1)(B), achieving a financial accounting benefit shall not be taken into account as a purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of Federal income tax.

(5) Definitions and special rules. For purposes of this subsection—

(A) Economic substance doctrine. The term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

(B) Exception for personal transactions of individuals. In the case of an individual, paragraph (1) shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

(C) Determination of application of doctrine not affected. The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.

(D) Transaction. The term "transaction" includes a series of transactions.

7 Staff of the Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010" as Amended, in Combination with the "Patient Protection and Affordable Care Act." A mouthful, to say the least. However, for citation purposes, this article uses the cumulative Blue Book, General Explanation of Tax Legislation Enacted in the 111th Congress, prepared by the staff of the Joint Committee on Taxation.

8 Bluebook, at 378.

9 Bluebook, at 378-9, fn. 1034

10 Bluebook, at 379.

11 Bluebook, at 379.

12 September 14, 2010, an LB&I Directive, LMSB-20-0910-024.

13 LB&I-4-0711-015.

14 Allison Bennett, "IRS Field Directive on Economic Substance Doctrine Not Legal Precedent, Official Says," BNA Daily Tax Report, October 7, 2011

15 The activities in the second-tier Irish entity are intended to qualify as active business income for purposes of Subpart F, Section 951 et. seq., and this could be accomplished in several ways, but for purposes of this hypothetical (and to extract the complexity of Subpart F from this already complicated fact pattern), this hypothetical assumes that the business in question qualifies as a bona fide licensing business and therefore the licensing income is not "subpart F income."

16 Technically, on Form 8832, the foreign entity that is to become a disregarded entity makes the "election," and its parent corporation then "consents" to the election. However, since the foreign entity is controlled by its parent, this article uses the not-inaccurate shorthand description that the parent "elects" to treat the subsidiary as a disregarded entity.

17 This is a classic "Double Irish" structure, and eliminates payments that could create issues or problems under Subpart F for U.S. income tax purposes, while also allowing the IP Sub to pay tax on a large portion of the licensing income from non-U.S. activities in Bermuda at zero or minimal tax rates. See Darby, Joseph B. III, "Double Irish More than Doubles the Tax Saving: Hybrid Structure Reduces Irish, U.S. and Worldwide Taxation," Practical International Tax Strategies, May 15, 07 p.2, V. 11, No. 9.

18 Reg. § 1.367(d)-1T(g)(4)(i) (first sentence). Instead, the sale of the intangible property in this transaction is governed by Section 482 and the related regulations, which in fact authorize a sale transaction but then seek to protect the interests of the federal government by providing special valuation rules to ensure that the transfer price is appropriate by applying a "commensurate with income" standard. The rationale is stated in the Section 482 White Paper: "Sales and licenses of intangibles are … not transactions described in Section 351 or 361."

19 Currently, there are two sets of cost-sharing regulations,

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Reg. § 1.482-7A, applicable for periods before January 4, 2009, and Reg. § 1.482-7, finalized in December 2011. The sheer complexity and detail of these regulations should provide ample protection under the Congressional Plan exception (as interpreted and implemented by the IRS) to any taxpayer that makes a reasonable, good-faith effort to comply with these regulations. Note that while the scary penalty provisions enacted in conjunction with the ESD purport to provide no "good faith" exception, the reality is that both the Basic Business Transaction exception and the Congressional Plan exception have *always* been read broadly in practice (remember, this is *not* a change in the law!) and so a good-faith effort to comply with the cost-sharing regulations means that the IRS's remedy is to audit and exercise the Commissioner's powers to adjust under Section 482, and not a right to attack the transaction itself under the ESD.

20 This is an attempt to condense the much more verbose language of Section 954(d)(1), which states in relevant part as follows:

For purposes of subsection (a)(2), the term "foreign base company sales income" means income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person where—

(A) the property which is purchased (or in the case of property sold on behalf of a related person, the property which is sold) is manufactured, produced, grown, or extracted outside the country under the laws of which the controlled foreign corporation is created or organized, and

(B) the property is sold for use, consumption, or disposition outside such foreign country, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption, or disposition outside such foreign country.

21 Since one of the steps in the transaction structure is to use the "check-the-box" election to treat the Licensing Sub as a disregarded entity, the licensing transaction technically ceases to exist (i.e., Licensing Sub is disregarded and is subsumed into IP Sub). However, it does seem appropriate to examine each step or element in the overall transaction and evaluate whether and why each step should fall outside the scope of the ESD.

22 Moreover, even if there is non-arms-length pricing (or otherwise inadequate pricing under Section 482) in this licensing transaction, that abuse is properly covered and addressed under the statutory scheme contained in Section 482, and the authority of the Commissioner to re-characterize transactions, and should not be awkwardly shoe-horned into a disallowance based on a violation of the ESD. The ESD should be used solely to address the substantively thin and chimerical arrangements that the courts have long found to lack "economic substance" under the common law, and not transactions that are economically substantive but where the choice of structural path is influenced—or even wholly governed—by tax considerations.

23 The check-the-box election is pursuant to Reg. §§ 301.7701-2 and -3.

24 The case of *United States v. Kintner*, 216 U.S. 418 (9th Cir. 1954), and a prior U.S. Supreme Court case, *Morrissey v. Commissioner*, 296 US 344 (1935), spawned regulations under Section 7701 based on two primary and four secondary characteristics that distinguished corporations from partnerships. These regulations were replaced by the check-the-box regime in 1997.

25 For example, the Obama Administration has at various times proposed a law change that would eliminate check-the-box for non-U.S. subsidiaries of a U.S. corporate group. This suggests both that the current statutory scheme permits such elections, and that a legislative change is the appropriate remedy. Congress, after all, both makes and changes tax laws under the Constitution, and the IRS merely enforces those laws. It is also worth noting in passing that most if not all "check-the-box" decisions involving foreign subsidiaries result in a reduction of *foreign* taxes rather than U.S. taxes, e.g., by allowing the Licensing Sub to pay royalties the to IP Sub that reduce Irish income taxes, while allowing IP Sub to avoid creating Subpart F income. Absent the check-the-box decision, IP Sub would simply be located in Ireland, pay more in Irish taxes, and still avoid U.S. Subpart F taxation on the non-U.S. income.

26 Arguably, customer relationships would even more clearly belong to the foreign subsidiaries under a distribution model rather than an agency model, and in fact the IRS might argue that under the agency model the foreign customers actually "belong" to the USCo. Query whether, in the present situation, the IRS might argue that valuable "customer intangibles" are being "transferred" by USCo to the foreign subsidiaries, with attendant consequences under Section 367. A defensive planning strategy to address this issue—certainly awkward but possibly effective—would be to have the USCo continue to service "existing" customer relationships, while IrishCo and its subsidiaries service only new customers. However, that bifurcated arrangement would undermine the intended efficiencies of the new structure, so the more practical answer would probably be to address and manage the risk. Note that "customer intangibles" have been proposed by the Obama Administration to be included in the categories of property subject to Section 367(d), but the proposal has not been enacted into law.

27 The "check-the-box" election needs to be made timely and needs to take effect *after* the transfer of the foreign subsidiaries to the IrishCo, because a premature election would cause a deemed liquidation of the foreign subsidiaries to occur prior to the transfer to IrishCo, which would require USCo to report as income the "all earnings and profits amount" of the foreign subsidiaries, and the transfer of the foreign subsidiaries to IrishCo then would be recast as an outbound transfer of assets rather than foreign stock, with very considerably different tax consequences under Section 367, especially with respect to any intangible property potentially governed by Section 367(d). Assuming the check-the-box election is made after the transfer for IrishCo, the election is treated for US federal income tax purposes as a liquidation of each second-tier foreign subsidiary into IrishCo, and should generally be "tax free" under Section 332, since a liquidation of a foreign subsidiary into another foreign subsidiary is generally eligible for nonrecognition under that Code Section. However, be aware that there are circumstances where a subsidiary liquidation can be a taxable event (e.g., if the subsidiary is insolvent) and it is further possible that a taxable liquidation could generate

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Subpart F income, although it is probably unlikely in the present case.

28 Arguably, the Basic Business Transaction exception should recognize that forming or restructuring a corporate group is inherently a "business" purpose, even if the restructuring itself is guided and motivated *solely* by tax strategies. The point is that a business has to have *some* operating structure (inherently the "business purpose") and it is entirely normal for that structure to be created (and later modified, e.g., through tax-free "reorganizations") for reasons based entirely on tax consequences. In the present case, however, it seems in all events clear that a business purpose is present, based on forming a corporation (thereby providing limited liability) in Ireland (and therefore availing the entity of the benefits and protections of Irish law, including access to the Irish court system, the Irish treaty network and the related advantages of participation in the European Union).

29 *See* Section 954(d)(1), the text of which is found in footnote 20, above.

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Securitization

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concern that without a statutory extension of the effective date or clear and definitive regulatory guidance in the absence of final regulations, the securitization markets could experience real disruption, especially in certain sectors such as the asset-backed commercial paper markets.

The Volcker Rule restricts proprietary trading and investing in or sponsoring "hedge funds" and "private equity funds" by "banking entities." The term "banking entities" includes not only FDIC-insured institutions, bank holding companies, savings and loan holding companies and foreign banking organizations, but also entities that are affiliated with any of the foregoing.

The Volcker Rule restricts proprietary trading and investing in or sponsoring "hedge funds" and "private equity funds" by "banking entities." The term "banking entities" includes not only FDIC-insured institutions, bank holding companies, savings and loan holding companies and foreign banking organizations, but also entities that are affiliated with any of the foregoing. In addition to the "proprietary trading" and the investing and sponsoring prohibitions, the rule also prohibits any such "banking entity" from engaging in "covered transactions," as defined in Section 23A of the Federal Reserve Act with any such "hedge fund" or "private equity fund" that the bank or related affiliate sponsors, manages or advises.

The Volcker Rule's definition of "hedge funds" and "private equity funds" includes any entity that would be an "investment company" under the Investment Company Act of 1940 ("ICA") but for the exemptions provided in the ICA for entities with less than 100 beneficial owners (Section 3(c)(1)) or companies that issue securities only to "qualified purchasers" (Section 3(c)(7)). These two exemptions are used by many securitization vehicles, as well as entities more commonly considered to operate as traditional "hedge funds" and "private equity funds." By defining "hedge funds" and "private equity funds" in relation to the ICA, rather than by the activities of the entities, the Volcker Rule would prohibit or greatly restrict the ability of "banking entities" to participate in traditional securitization transactions.

This result seems contrary to the intent of the Volcker Rule. Congress included Section 13(a)(2) in the Volcker Rule, which provides that "nothing in the Volcker Rule shall be construed to limit or restrict the ability of a banking entity or nonbank financial company…to sell or securitize loans in a manner otherwise permitted by law." However, rather than exempting entities that engage in securitization transactions from the scope of the rule, notwithstanding those entities' reliance on the ICA exemptions described above, the regulators adopted an approach in the proposed regulations to exempt some, but not all, securitization activities from some, but not all, of the restrictions of the rule.

The proposed regulations, published in November 2011, received over 15,000 written comments and responses. Representative Barney Frank criticized the proposed rules as "far too complex" and urged regulators to issue simplified regulations by early September. Commentators have called the proposed rules' provisions on securitization insufficient to give proper effect to the statute's directive to not restrict or limit a banking entity's ability to sell or securitize loans. The Dodd-Frank Act mandated that the Financial Stability Oversight Council ("FSOC") conduct a study on the intended scope of the Volcker Rule and required the rulemaking agencies to consider such study in formulating the implementing rules. The FSOC study noted that "Congress determined that none of the restrictions of the Volcker Rule, nor the "backstop" restrictions on permitted activities, will apply to the sale or securitization of loans." FSOC recommended that the agencies consider narrowing the statutory definition of "hedge fund" and "private equity fund" where appropriate. Exempting entities that primarily engage in the business of issuing "as-

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set-backed securities" (as defined in the Exchange Act) from the Volcker Rule is a simple and effective approach that would address both Representative Frank's and the industry's concerns. Doing so would fully effectuate the intent of Congress in adopting the loan securitization exclusion of Section 13(a)(2).

Under the proposed rules, many traditional securitization activities would be significantly restricted or even prohibited. For example, there is concern that asset-backed commercial paper (ABCP) conduits sponsored by banks or bank related entities would no longer be viable. The proposed rules allow bank sponsorship of "covered funds" (i.e. hedge funds and private equity funds) investing solely in "loans" (defined to include loans, leases, receivables and certain other extensions of credit), which theoretically allows a bank to sponsor an ABCP conduit. However, many of the associated activities necessary for a bank to create a marketable ABCP program, such as providing liquidity or credit support, would be prohibited as a "covered transaction" between a bank and an affiliate (in this case, a covered fund) under 23A of the Federal Reserve Act. Additionally, if an ABCP conduit includes assets other than those described in the definition of "loan," such as guarantees, credit default swaps, and asset-backed securities backed by loans, that conduit would not qualify for sponsorship by a covered banking entity. The regulating agencies have been urged to provide a broad based ABCP exclusion to be included in the final rules.

The narrowness of the "loan" definition in the proposed rules is problematic for many types of transactions. For example, traditional vehicle and equipment lease securitizations commonly use special purpose trusts to hold title to the assets. Titling trusts were developed in 1994 by World Omni Financial Corp. and are a useful and practical tool to comply with state requirements regarding title transfer and provide significant state tax advantages that reduce transaction costs and provide for financing efficiency. The lease originator would transfer title and its interests in and to the leases, including the right to receive lease payments, and the residual interests in the leased assets, from time to time to a titling trust. The titling trust would issue to the securitization entity trust certificates representing the beneficial interests in the trust's assets, and the proceeds payable from the beneficial interests would be used to pay debt service on the securities. However, because asset-backed securities such as titling trust certificates are not "loans," banks would no longer be able to avail themselves of this structure, forcing banks to pass along higher costs to its lessees or to exit the business altogether.

Because asset-backed securities such as titling trust certificates are not "loans," banks would no longer be able to avail themselves of this structure, forcing banks to pass along higher costs to its lessees or to exit the business altogether.

Loan assets often are backed by third party credit support, such as letters of credit, insurance policies and guarantees, none of which is included in the "loan" definition as a permissible asset. Loan securitizations often include provisions for holding cash and investing in "permitted investments." It is

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not clear that these activities fall within the loan exclusion. One commentator suggested that the definition of "loan" be rewritten to include any credit instrument, obligation or other similar asset that a banking entity could own or deal in, thus preserving for banking entities the availability of securitization for originating, managing and dealing with its assets and not interfering with its traditional credit extension activities.

The concerns with the proposed rule extend beyond the narrowness of the "loan" exception. The Volcker Rule provides that banking entities that sponsor a "loan" securitization vehicle may retain an ownership interest in the vehicle in an amount not greater (italics added) than required to meet the risk retention rules of Section 15G of the Exchange Act. However, sponsors of securitizations often retain a greater ownership percentage to comply with other legal requirements or to meet the needs of the market. Article 122a of the European Union Capital Requirements Directive, for example, requires that for credit institutions to receive more favorable capital treatment such credit institutions may invest only in securitizations in which, among other things, the originator retains a "material net economic interest" of at least 5% (italics added). When the sponsor retains a substantial economic interest, the interests of the sponsor and the interest of the investors are better aligned, which was the rationale behind Section 15G. If the market or the rating agencies demand greater retention, the financial consequences of not providing that retention due to the limitations of the Volcker Rule may be reduced investor demand, higher interest costs or both.

The proposed regulations also prohibit "banking entities" from engaging in "covered transactions" (as defined in Section 23A of the Federal Reserve Act) with "covered funds" that it sponsors. "Covered transactions" would include acting as servicer, providing repurchase commitments for breaches of representations and warranties, providing liquidity support to the securitization vehicle, providing hedges for rate, basis, or timing risk, and acting as underwriter or placement agent for its covered funds. The "covered transaction" restrictions impose a real barrier to a bank's ability to securitize its loan portfolio and seem to contravene the loan securitization exemption requirement of the Volcker Rule to not "limit" or "restrict" the ability of banking entities to securitize loans. The proposed regulations also would have the effect of classifying a bank as a "sponsor" to unaffiliated "covered funds" if it is engaged as a third party service provider to these "covered funds." This means that banks would be unable to provide services as a servicer, remarketing agent, trustee (with limited exceptions) or any other role where there is the power to exercise management or investment discretion. Often trustees are appointed as back-up servicers but their ability to manage the assets of the securitization entity is usually strictly governed by the transaction documents. The federal agencies have been urged to provide an exclusion in the final rules for these service activities.

Commentators have expressed other reservations about the proposed regulations as they relate to securitization, including the conflict of interest provisions and whether they are needed in light of specific conflict of interest regulations that will appear as Rule 127B under the Securities Act, the reach of the Volcker Rule to non-US banking institutions, the rules and restrictions governing market making by banks, and other areas that are either unclear or conflict with other applicable securitization regulation. Given the volume of comments received by the federal agencies on all of these topics and the complexity of the initial regulatory approach, it is understandable that final regulations have been delayed.

While the legislative response, including the Volcker Rule, to the financial meltdown of 2008 is understandable given the widespread impact on the American and world economy, Congress did recognize that the prohibitions on proprietary trading and ownership of hedge funds and private equity funds should not act as a constraint on the securitization market. As the FSOC noted, "the creation and securitization of loans is a basic and critical mechanism for capital formation and distribution of risk in the banking system." The final regulations, whenever they are issued, can and should provide a meaningful and effective "loan" securitization exemption as the statute requires. Representative Frank is correct in his call for a simplified approach. Excluding securitization entities from the definition of "covered funds" would achieve all of these goals. ❏

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