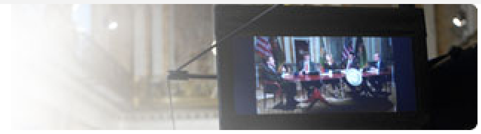

Treasury’s Issues Final Earnings Stripping Regulations to Narrowly Target Corporate Transactions That Erode U.S. Tax Base

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Regulations distinguish between debt and equity

WASHINGTON - Today, the U.S. Department of Treasury and the Internal Revenue Service (IRS) issued final regulations to address earnings stripping. This action will further reduce the benefits of corporate tax inversions, level the playing field between U.S. and non-U.S. businesses, and limit the ability of companies to lower their tax bills through transactions involving debt that do not support new investment in the United States. These regulations also require large corporations claiming interest deductions to document loans to and from their affiliates, just as businesses of all sizes do when they borrow from unrelated lenders. The rules were proposed in April along with temporary anti-inversion regulations. The final rules announced today are the product of extensive public comment and engagement.

“This administration has long called for legislative action to fix our broken tax system. In the absence of Congressional action, it is Treasury’s responsibility to use our authority to protect the tax base from continued erosion. We have taken a series of actions to make it harder for large foreign multinational companies to avoid paying U.S. taxes and reduce the incentives for U.S. companies to shift income and operations overseas. Such tax avoidance practices are wrong and should be stopped.” said Treasury Secretary Jacob J. Lew.

“Today’s final regulations are an important step in addressing earnings stripping, a commonly used technique to minimize taxes after an inversion. Throughout our rulemaking process, we sought comments to help narrow the rule and avoid any unintended consequences. We engaged extensively with businesses, tax experts, the public, and lawmakers and carefully considered their comments and recommendations. As a result of this process, the final rule effectively addresses stakeholder concerns by more narrowly focusing the regulations on aggressive tax avoidance tactics and providing certain limited exemptions.”

Coupled with Treasury’s previous actions to address corporate inversions, today’s final regulations balance the operational needs of companies while preventing the erosion of our U.S. corporate tax base. Specifically, today’s final regulations narrowly target problematic earnings stripping transactions – transactions that generate deductions for interest payments on related-party debt that does not finance new investment in the United States – while minimizing unintended consequences for regular business activities.

- <u>Exempting cash pools and short-term loans</u>: Treasury requested comments in the proposed regulations on whether special rules are warranted for cash pools, cash sweeps, and similar arrangements. In response to thoughtful feedback, Treasury is providing a broad exemption for cash pools, which are essentially common funding accounts for related businesses. Treasury is also providing an exemption for loans that are short-term in both form and substance.

- <u>Providing limited exemptions for certain entities where the risk of earnings stripping is low</u>: Transactions between foreign subsidiaries of U.S. multinational corporations and transactions between pass-through businesses are exempt from the final regulations. Financial institutions and insurance companies that are subject to regulatory oversight regarding their capital structure are also excluded from certain aspects of the rules.

- <u>Expanding exceptions for ordinary business transactions</u>: Treasury has significantly expanded the exceptions for distributions to generally include all future earnings and allowing corporations to net distributions against capital contributions. Treasury is also including additional exceptions for ordinary course transactions, such as acquisitions of stock associated with employee compensation plans.

- <u>Easing documentation requirements</u>: Treasury has relaxed the intercompany loan documentation rules for U.S. borrowers. The regulations also extend the deadline by one year until January 1, 2018.

Earlier this year, Treasury issued temporary regulations to limit inversions by disregarding foreign parent stock attributable to recent inversions or acquisitions of U.S. companies – the third step Treasury has taken since 2014 to limit inversions. The temporary regulations prevent a foreign company (including a recent inverter) that acquires multiple U.S. companies in stock-based transactions from using the resulting increase in size to avoid the current inversion thresholds for a subsequent U.S. acquisition. Treasury continues to work to finalize these regulations, which went into effect on April 4, 2016.

Treasury continues to believe that the best way to address both inversions and earnings stripping is to fix our broken business tax system, which is why we released an updated business tax reform framework in April and why we have continued to urge Congress to move forward on reform.

For more information on today’s action, see Treasury’s fact sheet.

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