Planning for Tax Controversies Before, During and After the Deal: New Dynamics in Cross-Border M&A Under the TCJA

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I. Introduction

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Considerable thought and commentary has been given to the numerous technical features introduced by P.L. 115-97 (Dec. 22, 2017), colloquially referred to as the "Tax Cuts and Jobs Act" (the "TCJA"). Nearly one-and-a-half years post-reform, tax advisors are continuing to navigate and adapt to the myriad ways in which the TCJA has affected how they interact with each other and with their clients in the M&A environment. In many respects, the TCJA has not changed the basic cross-border M&A playbook. Deal agreements are being drafted with much of the same infrastructure with respect to the general rights and obligations of buyers and sellers as existed in the market before, though several of the key international changes brought about by the TCJA have altered a number of pre-reform negotiating dynamics between buyers and sellers, amplifying existing and introducing new concerns and opportunities with respect to deal practice. The "global intangible low-taxed income" ("GILTI"), "base erosion anti-abuse tax" ("BEAT"), Code Sec. 965[1] transition tax, Code Sec. 163(j) interest limitations, the Code Sec. 245A participation exemption, and foreign tax credit ("FTC") regimes, just to name a few, each impact the evaluation, analysis and papering of international M&A deals.

This article considers several of the TCJA's changes in the context of cross-border M&A deal practice, focusing on how reform has altered certain deal dynamics and considerations. The article proceeds in four sections. First, this article sets up a basic deal example used for illustrative purposes throughout. Second, this article provides an overview of the general parameters and framework of a cross-border deal, discussing basic deal terms, negotiating points and considerations. Third, this article considers some of the new dynamics

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introduced by the TCJA and how commonly applicable aspects of cross-border M&A were altered as a result. Lastly, this article describes why the TCJA increased the number of situations in which post-closing actions can affect each of the parties and why the parties may expect to have more interaction post-closing than they would have had before reform. The tax procedure and controversy dynamics and practicalities under this new regime have thus become more critical for the transactional lawyers to understand and negotiate around in the deal documents.

II. Let's Make a Deal

A. Transaction Structure

Tax lawyers, like their corporate counterparts, must understand the structure of the deal before drafting any of the governing tax provisions of the acquisition agreement. The key tax considerations related to any deal will largely depend on whether the transaction is an acquisition of target equity or assets (or both), the location of such targets or assets, and whether the buyer is offering equity, cash or other property, or a combination. Some of the fundamental questions for any deal are:

- Who are the seller and the buyer?
  - U.S. or foreign;
  - Corporate parent or an affiliate of parent; or
  - Presence of a consolidated group (*e.g.*, U.S. parent of a consolidated group).
- What is being sold?
  - Assets;
  - Equity; or
  - Both assets and equity.
- What is the consideration?
  - Cash;
  - Equity; or
  - Earnouts or purchase price adjustments post-closing.

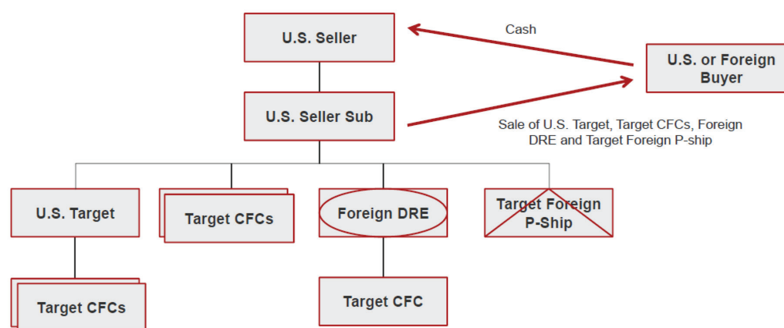
The "Base Case" transaction for this article is the taxable acquisition by a large domestic or foreign corporate buyer ("Buyer") of "controlled foreign corporations" ("CFCs"), U.S. corporate affiliates with direct CFC subsidiaries and foreign assets from a large U.S.-parented corporate seller ("Seller") solely for cash consideration (*see* Figure 1).

Unless indicated, assume all affiliates of Seller are, directly or indirectly, wholly owned by Seller. Seller will sell certain entities directly, either to Buyer or a subsidiary of Buyer, and certain Seller subsidiaries will sell entities to Buyer or a subsidiary of Buyer. Buyer and Seller are calendar year taxpayers. The transaction is signed in January and closes on June 30 of the same calendar year (the "Closing Date").

Below is a list of defined terms that are recurring throughout this article based on this illustrative transaction:

- "Seller Affiliates" means all subsidiaries owned directly or indirectly by Seller.
- "Target Entities" means all Seller Affiliates whose shares are sold to Buyer.
- "Target Subsidiaries" means any subsidiary of a Target Entity. For example, if a Seller Affiliate sells a Dutch affiliate that owns a German subsidiary, the Dutch entity is a Target Entity and the German entity is a Target Subsidiary.
- "Target Assets" means assets of Seller or a Seller Affiliate (other than interests in Target Entities) that are sold to Buyer.
- "Pre-Closing Tax Period" means any taxable period that ends on or before the Closing Date and, with respect to

FIGURE 1. BASE CASE



any Straddle Period, the portion of the Straddle Period ending on and including the Closing Date.
- "Post-Closing Tax Period" means any taxable period that begins after the Closing Date and, with respect to any Straddle Period, the portion of the Straddle Period beginning on the day after the Closing Date.
- "Straddle Period" means any taxable period that includes, but does not end on, the Closing Date.
- "Pre-Closing Taxes" means taxes incurred or accrued during a Pre-Closing Tax Period.

B. Objectives

While every deal is different, the typical objectives in a transaction such as the Base Case might be summarized as set forth below.

1. Buyer Objectives

The objectives of Buyer in drafting the tax provisions in the acquisition agreement and executing the transaction are generally as follows:

- Obtain a step-up in basis in all assets, whether purchased directly or owned by Target Entities and Target Subsidiaries;
- Match acquisition debt with operating earnings of the acquired business (with potential arbitrage opportunities);
- In-country planning for purchased assets, including stripping out high-margin intellectual property;
- Limit exposure in Post-Closing Tax Periods to tax liabilities of Seller's business related to Pre-Closing Tax Periods;
- Limit withholding tax risks that could impact Buyer; and
- Set the stage for post-closing restructurings and add-on acquisitions.

Buyer's general objective on every economic point in the deal is to ensure it is getting what it is paying for. Taxes inherited in the deal, like any other legal liability, reduce the economic value of the business and Buyer will seek to allocate any tax-related risks accordingly.

2. Seller Objectives

The objectives of Seller in drafting the tax provisions in the acquisition agreement and executing the transaction are generally as follows:

- Maximize the use of any tax deductions, credits and other tax attributes, including the Code Sec. 245A participation exemption, FTCs and existing net operating losses ("NOLs") or capital losses;
- Narrow any tax-related representations;
- Limit exposure in Post-Closing Tax Periods on tax liabilities of Seller's business related to Pre-Closing Tax Periods; and
- Minimize (or eliminate) withholding that may apply to payments of the deal consideration and obtain advance notice of any withholding that does apply.

Buyer's objectives will often directly conflict with the primary objectives of Seller—get as much proceeds as possible regardless of value and walk away completely. As with any economic transaction, Seller wants to maximize the amount it will receive in the deal, minimize any indemnification obligations and shift risks to Buyer, including tax-related risks, where possible.

III. Coming to (Contractual) Terms

Irrespective of whether the acquisition agreement is governed by U.S. law, the laws of the U.K., or the laws of Kazakhstan or Equatorial Guinea, the fundamental tax provisions of a deal, while subject to contractual rearrangement depending on drafters and governing law, typically remain the same:

- Purchase Price and Payment Provisions (allocation, tax treatment and withholding);
- Tax Representations;
- Tax Covenants (those that apply between signing and the Closing Date and those that apply in Post-Closing Tax Periods);
- Tax Indemnification (breach of representations and/or covenants and Pre-Closing Taxes);
- Tax Procedure (filing returns, refunds and tax elections); and
- Control over Tax Disputes.

Each is discussed in turn below.

A. Purchase Price and Payment

How much? When? Is there an escrow arrangement? Is the consideration subject to a known withholding tax, or is there a risk of withholding tax if one side or another determines that a potential withholding tax is required?[2] All of these are essential questions that comprise a variety of tax-related considerations.

1. How Much and When?

Although it is common to have a fixed dollar amount to be paid to Seller set in the agreement, a number of factors could cause that amount to fluctuate at and following closing.

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For example, the price might increase or decrease based on a working capital adjustment. Working capital generally equals current assets ("CA") less current liabilities ("CL"). A working capital adjustment modifies the purchase price to reflect changes in working capital between a reference date and the Closing Date. The adjustment, positive or negative, is the working capital at the Closing Date less a peg number set as the target working capital.

As an arithmetic equation:

$$(CA_{Closing} - CL_{Closing}) - (CA_{Reference} - CL_{Reference})$$

Here, it is important to achieve clarity about whether and how the working capital adjustment accounts for tax asset and tax liabilities, such as whether they are included in closing net working capital, target net working capital or both.[3] Moreover, the agreement might include payments that both reflect an adjustment to the purchase price and occur after the Closing Date, such as earnouts attributable to the productivity of the Target Entities or Target Assets.[4]

2. Purchase Price Allocations

Purchase price allocations address the allocation of consideration among different asset classes and the allocation of consideration to different Target Entities or Target Subsidiaries. Purchase price allocation provisions at signing typically do not specify the actual allocations themselves. Instead, they address the process of coming to terms and how any disputes are settled.

A typical provision may contain language similar to the following:

> No later than ninety (90) days after the Closing Date, Buyer will prepare and deliver to Seller an allocation schedule (the "Allocation Schedule") allocating the amount of consideration paid, or treated as paid (including any assumed liabilities as determined for U.S. federal income tax purposes), among the Target Entity equity interests and Target Assets in accordance with Section 1060 of the Code and the Treasury Regulations thereunder (and any comparable provision of state or local tax law). Seller will provide Buyer with written notice if it disputes any items set forth on the Allocation Schedule within thirty (30) days of delivery thereof along with a statement setting forth the basis of the dispute. The parties hereto shall act in good faith to resolve any dispute regarding the allocation of purchase price. If the parties hereto cannot resolve any disputed item, the disputed item shall be resolved by an accounting firm from among the four listed on Schedule ____, to be selected by Buyer. If the purchase price is adjusted pursuant to this Agreement, the Allocation Schedule shall be adjusted in a manner consistent with the procedures set forth in this section.

As a general matter, the parties will each want the other to report the sale consistent with the allocation, but it is also typical for each side to be allowed to settle any exam over the issue without having to litigate the positon:

> Buyer and Seller shall file all tax returns (including, but not limited to, IRS Form 8594) consistent with the Allocation Schedule. Neither Buyer nor Seller shall take any tax position inconsistent with the Allocation Schedule; provided, however, that nothing contained herein shall prevent Buyer or Seller from settling any proposed deficiency or adjustment by any taxing authority based upon or arising out of the Allocation Schedule, and neither Buyer nor Seller shall be required to litigate before any court any proposed deficiency or adjustment by any taxing authority challenging the allocation set forth on the Allocation Schedule.

From Seller's standpoint, it may be important to allocate the purchase price in a specified manner to different Target Entities, Target Subsidiaries or Target Assets so as to support prior transfer pricing metrics on Seller's group. Under the assumption that all taxing authorities will review the relevant documentation, a high value allocation to a Target Subsidiary in, say, Italy, might well be inconsistent with prior transfer pricing profitability levels of that Target Subsidiary.

B. Withholding on Purchase Price

There was a time in the M&A world when a withholding provision embedded in a purchase price section read simply that Buyer would be allowed to deduct and withhold as required by applicable law (U.S. or foreign) and that any amount deducted or withheld would be treated as paid to the party on behalf of whom such deduction or withholding was made. As deals have become more global in scale, however, parties have become much more attuned to potential surprises at closing, as more countries have sharpened their withholding provisions where some portion of Target Assets, Target Entities or Target Subsidiaries are located in such country.

This is particularly true of several emerging market jurisdictions such as India, China and certain countries in Latin America, which can impose withholding taxes where Seller transfers a Target Entity which itself owns

shares in a Target Subsidiary located in such jurisdiction. For example, if the deal includes a transfer by a U.S. Seller Affiliate of, say, a Cayman holding company which itself owns an Indian Target Subsidiary, the purchase price amount might be subject to an Indian withholding tax. These situations can often lead to contentious negotiations between the parties over whether and how much withholding tax is due, resulting in frustrating conversations with local counsel on both sides as to the precise manner in which the rules apply and how any withholding tax is calculated.

Buyer is concerned that it is on the hook for any withholding taxes that remain unpaid, while Seller is primarily worried about the amount of cash it receives. Moreover, Seller will have an eye on the ability to claim a U.S. FTC for taxes withheld on Buyer's purchase price amounts, which is ever shrinking under the TCJA.[5]

Generally, Buyer will want a provision giving it broad power to withhold and treating withheld amounts as paid to Seller. If the transaction involves an escrow, Buyer will also want to be able to obtain a portion of any distributions from the escrow in order to satisfy its withholding tax requirements.

A Buyer-friendly withholding provision might read:

> Each of Buyer, the Target Entities, any of their respective Affiliates and the escrow agent shall be entitled to deduct and withhold from amounts otherwise payable pursuant to this Agreement or the escrow agreement such amount as such party is required to deduct and withhold under the Code, the rules and regulations promulgated thereunder, or any provision of state, local or non-U.S. tax Law. To the extent that amounts are so withheld or deducted, such amounts shall be treated for all purposes of the Agreement as having been paid to the person in respect of whom such deduction and withholding was made. For the avoidance of doubt, to the extent any amounts are required to be so withheld or deducted from any distributions from the escrow account, such amounts shall be distributed to Buyer (or an entity designated by Buyer) to enable Buyer (or such designated entity) to comply with its withholding obligations (including without limitation, any withholding obligations of the Target Entities).

On the other hand, Seller would prefer to have withheld amounts minimized so as to avoid any related reduction in the amount of cash or other consideration received. The parties will negotiate over concepts such as:

- Agreeing that no withholding applies, or specifying a fixed amount of any that does;
- Requiring prior notice of Buyer's intent to withhold;
- Requiring Buyer to take reasonable steps to minimize withholding;
- Engaging the opinion of a local advisor before any withholding is allowed;
- Designating which side has the authority under the contract to negotiate with local tax authorities and manage any examination[6]; and
- In certain cases, a gross-up or other similar mechanism.

Unlike some of the ambiguities with respect to foreign-U.S. withholding taxes, the major U.S. withholding provisions applicable to cross-border transactions, such as FIRPTA withholding and backup withholding, can generally be addressed with relative ease through the provision of the requisite certificates.[7]

C. Tax Representations

Tax representations ("tax reps") are statements about the prior and current tax-related matters of the Target Entities and Target Subsidiaries. As with other Seller representations in the acquisition agreement generally, tax reps often include disclosure schedules, which effectively provide carve-outs for specific items from particular representations.

Although their scope will vary depending on the type of deal and target, among other factors, tax reps serve several protective functions for Buyer in any deal.[8] They constitute a form of diligence about the tax compliance and tax history of the Target Entities and Target Subsidiaries and facilitate confirmation of fundamental assumptions about them. If the representations are determined not to be true on the Closing Date, Buyer may have recourse against Seller, including, in certain cases, not being required to close the deal.[9] After the Closing Date, a breach of tax reps can form the basis for Buyer to make indemnification claims against Seller, independent of any separate "bright line" indemnity that might exist for Pre-Closing Taxes.[10]

Tax reps will also be subject to limitations based on the disclosure schedules Seller prepares in connection with the acquisition agreement. Disclosure schedules provide Buyer notice of a particular fact that would otherwise amount to a breach of a representation but in a manner that causes it to fall outside of the representation such that it will not prevent the deal from closing. Pending exams and tax elections are common circumstances where disclosure schedules are utilized by Seller when

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Seller would otherwise be unable to give a "clean" representation about a particular issue.

Generally speaking, Seller prefers to limit representations by including knowledge and materiality qualifiers. Further, Seller generally seeks to limit or avoid representations about the amount or availability of specific target tax attributes in a Post-Closing Tax Period, such as basis, NOLs, previously-taxed income ("PTI") or Code Sec. 163(j) carryforwards, and will often seek to include "ring-fencing" language making clear that tax-related representations are limited to those identified in specific sections of the agreement. Accordingly, a Seller friendly limitation on all tax reps might look like the following:

> This Section ____ contains the sole and exclusive representations and warranties of Seller with respect to Taxes. Any claim for breach of representation with respect to Taxes shall be based on the representations made in this Section ____, and shall not be based on the representations set forth in any other provision of this Agreement. Nothing in this Section ____ or otherwise in this Agreement shall be construed as a representation or warranty with respect to: (i) the amount or availability of any net operating loss, capital loss, Tax credit, Tax basis or other Tax asset or attribute of the Target Entity or any Target Subsidiary in any taxable period (or portion thereof) beginning after the Closing Date, or (ii) any Tax position that Seller or its Affiliates (including the Target Entity and Target Subsidiaries) may take in respect of any taxable period (or portion thereof) beginning after the Closing Date.

Additional Seller strategies to limit the scope of tax reps might also play out in the definitions of the agreement. The definition of "Taxes" is critical in this regard, and Seller might negotiate specific limitations to that definition that otherwise limit the tax reps and covenants throughout the agreement.

The remainder of this Part III.C separates tax reps into five general categories: Prior Tax Returns and Filing; Prior Payment and Compliance; Audits, Disputes, or Other Interactions with Taxing Authorities; Tax History and Related Documentation; and International Tax Issues and Reps. The passage of the TCJA had more limited impact on the relevant considerations and negotiation dynamics in the first four categories, so this article provides only a brief review of each, including sample language. On the other hand, the passage of the TCJA has amplified the significance and immediacy of considerations related to international tax issues and reps, which are addressed in greater detail below.

1. Prior Tax Returns and Filing

Language here typically includes whether a Target Entity's (and any Target Subsidiaries') prior tax returns have been timely filed and whether they were complete and accurate. Language might also include whether a Target Entity or Target Subsidiary has requested any filing extensions that have been granted.

A sample might read[11]:

> All [material] Tax Returns required to be filed by, with respect to, or that include the Target Entity and Target Subsidiaries have been timely filed and all such Tax Returns are true, correct and complete in all [material] respects. There are no outstanding rulings of, or requests for rulings by, any Governmental Authority addressed to the Target Entity or any Target Subsidiary that are, or if issued would be, binding on the Target Entity or any Target Subsidiary. Neither the Target Entity nor any Target Subsidiary have requested or been granted an extension of the time for filing any Tax Return that has not yet been filed, other than those extensions requested and granted in the ordinary course of business.

Negotiations primarily center around what tax returns are subject to this representation, as returns can span a spectrum from local country (United States or foreign) income tax returns of material subsidiaries to relatively minor returns for sales or property taxes, for example.

2. Prior Payment and Compliance

Language in these types of tax reps can encompass prior payment of taxes generally, payment of specific types of taxes such as withholding taxes, and the existence of agreements that require a Target Entity or Target Subsidiary to bear the economic responsibility of the taxes of another business entity. A sample might read:

> (i) All Taxes [due and owing by/] of the Target Entity and any Target Subsidiary—whether or not shown on any Tax Returns—have been paid [except to the extent such Taxes are contested in good faith and for which adequate reserves are included on the applicable Financial Statements of the Target Entity and Target Subsidiaries in accordance with GAAP].
>
> (ii) The Target Entity and Target Subsidiaries have withheld and paid all [material] Taxes required

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to have been withheld and paid—whether or not shown on any Tax Return—including in connection with amounts paid or owing to any employee, independent contractor, creditor, stockholder, or other third party.

Buyer might also be concerned that a Target Entity or Target Subsidiary has contractual liability for payments to other business entities or to taxing authorities on behalf of other business entities, based on the tax liability of those entities, as a result of tax sharing agreements, indemnification agreements or gross-up obligations in other contracts such as licensing agreements or financial derivatives. A representation covering those kinds of arrangements might say:

> The Target Entity and Target Subsidiaries are not a party to or bound by any Tax indemnity agreement, Tax sharing agreement, Tax allocation agreement, or similar contract, nor does the Target Entity or any Target Subsidiary have any liability to another party under any such agreement [(in each case, other than arrangements and agreements entered into in the ordinary course of business the primary purpose of which does not relate to Taxes and pursuant to which none of the Target Entity or any of the Target Subsidiaries have any material outstanding or future liability for Taxes)].

3. Audits, Disputes or Other Interactions with Taxing Authorities

The representations in this category address interactions with taxing authorities related to examinations, assertions of deficiencies, or claims for refunds. A relatively straightforward representation about deficiencies and refund claims might read:

> [During the prior three (3) taxable years,] No [unpaid] deficiency or adjustment in respect of Taxes has been claimed, proposed, asserted or assessed by any taxing authority against the Target Entity or any Target Subsidiary [in writing], and there are no outstanding refund claims with respect to any Tax or Tax Return of the Target Entity or any Target Subsidiary.

In addition to the general representation that may be included elsewhere addressing liens, Buyer may also want to ensure the absence of tax liens on any Target Entity, Target Subsidiary or Target Asset:

> There are no encumbrances for Taxes against any of the assets of the Target Entity or any Target Subsidiary [except encumbrances for which adequate reserves have been established under GAAP].

Buyer will also want to include representations about audits and examinations:

> (i) There are no audits, assessments, proceedings or other actions in progress, pending or, to Seller's knowledge, threatened or proposed against or with respect to any liability in respect of the Taxes of the Target Entity or any Target Subsidiary [other than those for which adequate reserves have been established under GAAP]. There are no pending rulings or advance pricing agreements under discussion with any taxing authority or other Governmental Entity with respect to Taxes.
>
> (ii) None of the Target Entity or any Target Subsidiary has waived any statute of limitations in respect of Taxes or agreed to any extension of time with respect to a Tax assessment or deficiency, nor has any request been made for any such extension or waiver.

4. Tax History and Related Documentation

This category of representations often entails Buyer requesting a list of specific tax characteristics and attributes of Seller, the Target Entities, Target Subsidiaries or Target Assets that Buyer needs Seller to confirm. The particular representations in this category depend on the specifics of the deal, but commonly include:

- Buyer access to or Seller delivery of complete and accurate copies of tax returns, examination reports, and statements of deficiency;
- Check-the-box elections under Reg. §301.7701-3[12];
- Membership in a consolidated group, other than a group for which a Target Entity is the common parent;
- Status of any domestic Target Entity or Target Subsidiary as a U.S. real property holding corporation under Code Sec. 897(c)(2) during the previous five years[13];
- Participation in reportable transactions or listed transactions as defined in Reg. §1.6011-4(b);
- Participation in spin-offs and other reorganizations under Code Sec. 355[14]; and
- Recognition of income in Post-Closing Tax Periods by a Target Entity or Target Subsidiary, including as a result of tax accounting methods applied to transactions undertaken in Pre-Closing Tax Periods

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or agreements entered into with taxing authorities during Pre-Closing Tax Periods.[15]

Representations about the existence (or non-existence) of specific attributes—such as tax basis, NOLs (and Code Sec. 382 limitations), FTCs and PTI—or their availability in a Post-Closing Tax Period, however, are likely to be subject to greater negotiation. For example, Buyer might ask Seller to make a representation about the existence and availability of NOLs after the Closing Date and the non-existence of any limitation under Code Sec. 382 of tax attributes that Buyer specifically accounted for in calculating the purchase price.

Conversely, Seller should consider whether it wants to add a disclaimer about particular attributes to its representations for additional assurance in the same vein as the language in Part III.C above, in effect disclaiming responsibility for Buyer's ability to use a particular tax attribute in Post-Closing Tax Periods.

5. International Tax Issues and Reps

In transactions such as the Base Case where foreign corporations are being sold, Buyer will likely ask for all of the tax reps above and also request additional representations to cover issues specific to foreign Target Entities and foreign Target Subsidiaries.

These foreign Target Entity and Target Subsidiary specific tax reps commonly include representations about:

- CFC status[16];
- Inclusion of certain amounts in income under Code Sec. 951 and Code Sec. 951A assuming the Target Entity's tax year closes on the day after the Closing Date;
- In the case of any minority ownership in foreign entities owned by a Target Entity, PFIC status;
- Tax residency in any jurisdiction other than that of incorporation;
- Whether a foreign Target Entity or Target Subsidiary has a permanent establishment in any jurisdiction other than that of incorporation;
- Whether any of the foreign Target Entities or Target Subsidiaries carries a taint from a prior transaction which raises Code Sec. 7874 issues[17];
- Transfer pricing compliance and related documentation; and
- Whether any foreign Target Entity or Target Subsidiary holds U.S. property for purposes of Code Sec. 956.[18]

Now is a good point to note that several of the TCJA's provisions, particularly those in the international area, introduced some new dynamics Buyer and Seller must grapple with. The GILTI regime and the Code Sec. 965 transition tax are two examples of situations where some of the changing and intensified dynamics of the TCJA are apparent in cross border M&A diligence and negotiations. Other related TCJA provisions are discussed in Part IV below.

a. The GILTI Regime. One of the key changes from the TCJA impacting cross-border M&A is the addition of the GILTI regime.[19] GILTI has introduced a number of strategic considerations beyond what is included in the tax reps and related covenants. When it comes to negotiations between Buyer and Seller, the GILTI regime raises at least three issues in the context of the Base Case outlined above.

First, if there is a direct transfer of a CFC for which Buyer will make an election under Code Sec. 338,[20] then Seller, as a U.S. parented group, will be subject to the GILTI consequences (along with other potential consequences) from the deemed sale gain resulting from the election on any Target Entity or Target Subsidiary that is a CFC.[21] While the consequences of the deemed sale gain on Seller have been an issue in respect of the Subpart F and FTC rules for pre-TCJA years, the immediate and more certain impact of GILTI will likely sharpen the focus of both Buyer and Seller over this issue and may lead to more contentious negotiations over Buyer's contractual rights to make such an election.[22]

Second, if there is a direct transfer of a CFC by Seller for which Buyer will not make a Code Sec. 338 election and Buyer is a U.S. parented group,[23] then Buyer may be subject to the potential of a tested income inclusion as the owner of the CFC on the last day of the tax year.[24] This increases drafting complications, as the tax on GILTI is not an includable item until the end of the year. Buyer and Seller may thus need to specify how any GILTI amount will be treated for various purposes, including the taxes attributable to any tested income where the Closing Date falls on a day other than the close of a U.S. Target Entity's tax year.

The preceding two paragraphs outline issues that, to a degree, were present in the Subpart F rules prior to the enactment of the GILTI regime. As noted throughout this article, the intensity of these issues has sharpened given the wide-ranging implications of GILTI.

Third, GILTI is calculated taking into account a number of tax accounting items[25] generally on a group basis, whereas the "old fashioned" Subpart F income regime generally looked at items on a CFC-by-CFC basis. As such, the tax consequences from a sale of several CFCs out of the Seller group before year-end and placing them

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into Buyer's group are now more susceptible to factors outside of those particular CFCs, taking into account the wide-ranging impact of possible deficits, credits, assets and income within Seller's retained CFCs and Buyer's legacy CFCs.

These and other issues are discussed further in Part IV in an examination of some of the dynamics of cross-border M&A following the TCJA.

b. Code Sec. 965 Liability. Code Sec. 965 is, so to speak, in the history books as far as the factors that determined the Code Sec. 965 liability of the Seller group and any Target Entity in that group. But, as readers of this journal know, most companies made the election under Code Sec. 965(h) to pay this liability in installments over eight years. Buyer's potential exposure to tax liability under Code Sec. 965 will likely be the subject of an additional representation to the effect of the following:

> Neither the Target Entity nor any Target Subsidiary would be required to pay any Taxes pursuant to §965 in any Post-Closing Tax Period (or portion thereof), including, without limitation, by reason of an election under §965(h) or an election under §965(i).

As discussed further in Part IV below, the purchase of a U.S. Target Entity that has a Code Sec. 965 liability adds a new dynamic to cross-border M&A issues and interaction between Buyer and Seller in Post-Closing Tax Periods.

D. Covenants

The typical tax-related covenants are agreements about what the parties will do after signing and fall into two basic categories: covenants that apply between signing and the Closing Date and covenants that apply to Post-Closing Tax Periods.

1. Interim Covenants

Like most deals, the Base Case has a gap between signing in January and the Closing Date in June. The interim period between signing and the Closing Date presents Buyer with a risk that Seller might engage in an action that could impact Buyer in a Post-Closing Tax Period, or otherwise dilute Buyer's right to indemnification for a Pre-Closing Tax Period liability. Accordingly, Buyer will want to ensure Seller does not do anything to extract or impair the value of the Target Entities (or Target Assets and Target Subsidiaries) or alter the tax structure or attributes that Buyer would otherwise inherit in the deal.

For example, Buyer should be concerned that Seller might make an election under U.S. or foreign tax law that could change the tax posture of a Target Entity, Target Subsidiary or Target Asset. Similarly, Seller might settle a tax examination in a manner that reduces the potential for Seller indemnification in a Pre-Closing Tax Period but negatively impacts Buyer in a Post-Closing Tax Period. Given the variety of tax regimes around the world, each with their own nuances and, in many cases, idiosyncratic rules, it is impossible for Buyer to know what actions Seller might conceivably take that could fall into these categories.

As a result, Buyer will seek broad covenants to restrict Seller's actions after signing and before the Closing Date. Seller, on the other hand, will generally resist such restrictions (or at least the ones it feels are most onerous). Seller will argue that it needs to have the ability and flexibility to run its business and, therefore, does not want to be placed in the position of having to check with Buyer each time a relatively minor tax filing is due, an innocuous tax election must be made, or an immaterial tax dispute has to be settled.

Buyer will typically seek to restrict Seller from taking a number of actions before closing, including:

- Making, changing or revoking any tax election;
- Changing any tax accounting period or tax accounting method;
- Settling or compromising any outstanding tax dispute or audit;
- Filing any amended tax return;
- Entering into a tax ruling or requesting any such ruling from a taxing authority or other governmental entity;
- Extending or waiving the applicable statute of limitations for any tax period;
- Taking any action that would impede the intended tax treatment of the transaction, if any; and
- Taking or failing to take any action with respect to taxes that would materially decrease any valuable tax asset of Seller.

As usual, the parties will negotiate each point and might compromise over limitations based on materiality thresholds or Seller's past practice.

2. Code Sec. 338 Elections

A typical issue in a deal such as the Base Case is the covenants surrounding whether Buyer will make a Code Sec. 338(g) election with respect to the foreign Target Entities. The issues, both substantive and procedural, have been discussed at length in other articles.[26] Again,

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as has been detailed recently in this journal, the broadly applicable key points are:

- Buyer has the unilateral regulatory right to make the election[27];
- The election results in deemed sale gain to the foreign Target Entity[28];
- The election closes the tax year of the foreign Target Entity[29] and results in Buyer inheriting what is essentially a new corporation with respect to U.S. tax attributes[30]; and
- Buyer benefits from a basis step-up and resulting amortization.[31]

Because of Buyer's unilateral regulatory right, Seller and Buyer typically negotiate an acquisition agreement providing, one way or another, whether (i) Buyer can make the election at its determination after diligence, (ii) Buyer is required to make the election, or (iii) Buyer is precluded from making the election.

If Buyer makes an election under Code Sec. 338(g) with respect to the purchase of any foreign Target Entity, the regulations require Buyer to give notice to certain U.S. shareholders of the Target Entity if that Target Entity was a CFC or a PFIC at any time during the portion of the taxable year that ends on the Closing Date.[32] Failure to give notice can jeopardize the election.[33]

3. Information Sharing and Cooperation

After closing, both Buyer and Seller will likely have information that will be necessary to the other party in connection with any proceeding relating to taxes, making appropriate tax filings, or compiling financial statements. A general cooperation provision providing mutual access to each other's records is typical, subject to certain carve-outs.[34] As seen in Figure 2, tax disputes can last years—sometimes more than a decade—past the Closing Date. A broad cooperation provision is sometimes the only glue binding Buyer and Seller to work together as amicably as possible to resolve the dispute.[35]

4. Preparation and Review of Tax Returns

Buyer and Seller can both be economically affected by Pre-Closing Tax Period and Straddle Period returns, but the default position without any separate contractual provision dealing with tax return preparation is for the party that owns the Target Entities (and Target Subsidiaries) when their returns are due to make such filings. This will raise objections from Buyer, who will want to see returns filed after signing but before the Closing Date, as it is inheriting the business, and from Seller, who has an interest in returns for Pre-Closing Tax Periods filed after the Closing Date as it may be on the hook in Post-Closing Tax Periods under a Pre-Closing Tax indemnity.

a. Return Preparation Overview. As described with respect to the transaction structure, the tax periods relevant to the deal are usually divided into three periods: (1) Pre-Closing; (2) Straddle, and (3) Post-Closing. Figure 3 frames the analysis in terms of zones:

While the specific language covering the process of preparing and filing tax returns with respect to each of these zones—and each party's attendant rights and obligations—is typically the subject of heavy negotiation, the dynamics may be characterized quite simply:

- Buyer will want to look over Seller's shoulder with respect to the returns that Seller prepares which can affect Buyer;
- Seller will want to look over Buyer's shoulder with respect to the returns that Buyer prepares which can affect Seller; and
- Each party stands ready to object to any action in the other's domain that could prejudice that party.

FIGURE 2.

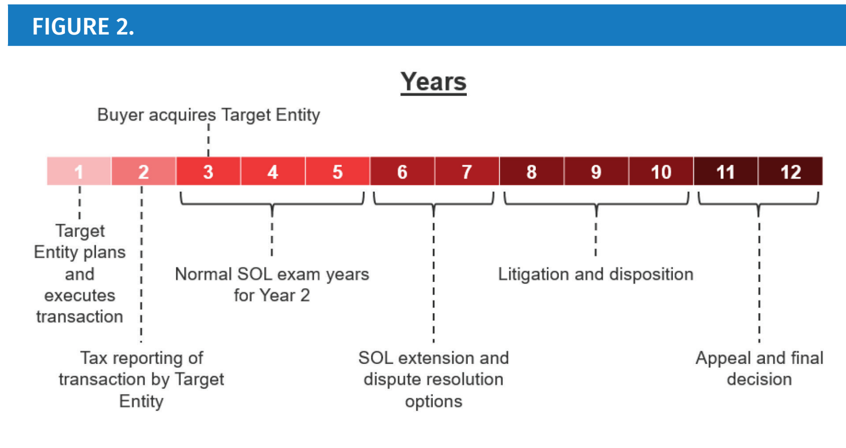
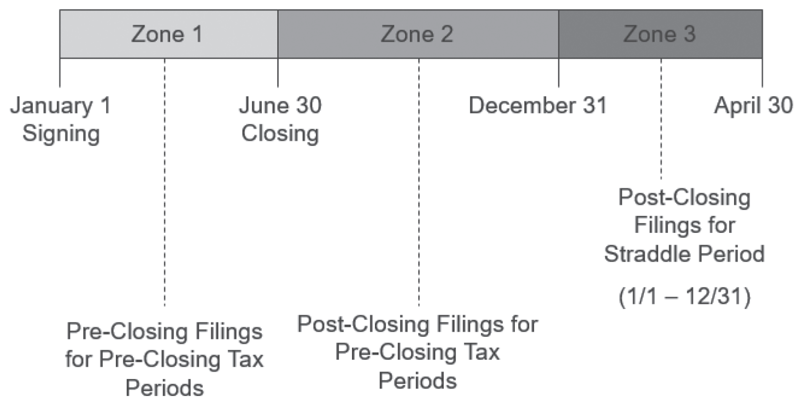


FIGURE 3.



If Seller is economically liable under a Pre-Closing Tax indemnity, it will seek to control any return related to those Pre-Closing Tax Periods. In cases like the Base Case, where the Pre-Closing Tax Period includes the part of the Straddle Period ending on the Closing Date, that set of tax returns includes not only Target Entity and Target Subsidiary returns due after the Closing Date with respect to years ended before the Closing Date but also any Target Entity and Target Subsidiary tax return for a Straddle Period. Tax returns for Post-Closing Tax Periods will typically be in the control of Buyer, subject to any tax-related covenant and restriction discussed above.[36]

b. Zone 1: Returns Filed Pre-Closing. The most common approach is for Seller to be responsible for the preparation and filing of Target Entity and Target Subsidiary returns filed on or prior to the Closing Date. Buyer, though, has an interest in knowing what will be on the return and potentially objecting to certain items if they (i) are inconsistent with past practices, or (ii) would otherwise bind Buyer to an aggressive or unfavorable tax reporting position.

The parties typically negotiate over whether Seller has to accept all comments reasonably requested from Buyer or simply consider them in good faith. In any event, Buyer will have limited time to review and comment on the relevant tax returns, sometimes varying by the type of return (*i.e.*, sales tax or excise tax returns versus income tax returns).

c. Zone 2: Returns Filed Post-Closing with Respect to Pre-Closing Tax Periods. Typically, Buyer will file these returns, subject to a commitment to treat items on them consistently with Seller's past practices (and, of course, applicable law). To the extent that the related taxes exceed accruals on the closing balance sheet, Buyer will push for Seller to pay them as a matter of course under the covenant so that Buyer will not have to resort to recover under any Pre-Closing Tax indemnity that may exist. Seller usually negotiates for the right to review and approve these returns with respect to conformity with the requirements of the agreement. Seller will typically seek terms requiring Buyer to accept all reasonable comments Seller makes to the returns.

d. Zone 3: Straddle Period Returns. Buyer usually prepares and files Straddle Period returns. The protections afforded Seller are typically similar to those with respect to Zone 2 returns, to the extent Seller remains liable for taxes related to the portion of the Straddle Period ending on the Closing Date. Those protections can include the right to review and comment on Straddle Period returns within a reasonable time, and a commitment that Buyer incorporate any reasonable changes requested by Seller for tax items that will affect Seller's liability under the indemnity.

e. Amended Returns. Seller will typically seek to prevent Buyer from filing an amended return for any Pre-Closing Tax Period, unless Buyer is required to do so under applicable law.

5. Control over Tax Disputes

The parties will typically negotiate extensively over control of tax audits, examinations or contests that begin in or continue into the Post-Closing Tax Periods, but relate to Pre-Closing Tax Periods. When Buyer and Seller draft and negotiate the provisions regarding control over tax disputes, they will typically be focused on certain fundamental considerations[37]:

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- Mutual cooperation;
- Notice;
- Record retention;
- Information sharing; and
- Precedence of the tax contest provision over the general contest provision, governing, for example, issues such as environmental, product liability and other similar claims against the Target Entities, in the indemnification arrangement in cases where the two may conflict.

a. Tax Contests Related to Pre-Closing Tax Periods. Typically, the more exposure Seller has for Pre-Closing Taxes, the harder Seller will negotiate to control contests related to them. That said, although Seller may be liable for Pre-Closing Taxes under the indemnity arrangement, Buyer will press its interest in managing the overall impact of any contests and participating in the process to protect Buyer's interests.

For instance, the Base Case deal closes on June 30, 2019. As of July 1, 2019, Buyer owns the Target Entities. On March 1, 2020, the Internal Revenue Service ("IRS") begins an examination related to a U.S. Target Entity's 2017 and 2018 tax years.

First, even with respect to 2017, which is a Pre-Closing Tax Period, the contest may affect a Target Entity's tax liability for tax periods entirely under Buyer's watch. For example, the outcome of the audit of the Target Entity's 2017 year might affect the size of the Target Entity's NOLs carried into 2020. Similarly, a contest about a particular tax accounting or transfer pricing method in the 2017 year could also implicate the Target Entity's liability in Post-Closing Tax Periods.[38]

Moreover, the example here posits an examination by the IRS. Issues around control over contests related to Pre-Closing Taxes can be, and usually are, more nuanced in the case of an examination by a foreign taxing authority. The relationship with taxing authorities outside the United States can mean more to Buyer with respect to its interests in the Target Entities than to Seller, who might have exited a foreign jurisdiction entirely by selling the Target Entities. Buyer will want the Target Entities to remain on good terms with the relevant foreign taxing authority, particularly in emerging market jurisdictions. Seller's approach to managing a Pre-Closing Tax Period contest in a particular jurisdiction might not be conducive to that relationship, as Seller's singular focus may be to reduce the monetary exposure of Seller's liability without concern to the ongoing ramifications of that approach to Buyer in Post-Closing Tax Periods.

Tax contest provisions for Pre-Closing Tax Periods attempt to account for all of these interests *ex ante*. As a result, they are highly negotiated and can often be among the more complex provisions of an acquisition agreement. Features include:

- Seller election to control tax contests involving Pre-Closing Taxes;
- Seller commitment to conduct tax contests diligently and in good faith;
- Buyer participation rights, including rights to notification and good faith consultation with a reasonable opportunity to comment before Seller takes any significant action or submits written materials; and
- Buyer consent rights with respect to payment, settlement, compromise, litigation or any other disposition of an item subject to a tax contest.

Additionally, the provision may address what happens in the event that Seller does not elect to control an eligible contest over a Pre-Closing Tax Period. Common agreements are that Buyer will keep Seller informed about the progress and substantive aspects of such a tax contest and that Buyer will not conclude or abandon it without obtaining the prior written consent of Seller.

Finally, while at the negotiating table, Buyer and Seller might want to consider whether each is interested in the particular tax treatment of any items or characteristics of a Target Entity (or Target Subsidiary) in a Pre-Closing Tax Period. If so, the parties may want to reach more specific terms with respect to contests about those items so that each has a continuing stake in them.

b. Disputes over Straddle Period and Post-Closing Tax Period Taxes. Buyer may seek to control disputes related to Straddle Period and Post-Closing Tax Period taxes. In some cases, however, a dispute about a Straddle Period or Post-Closing Tax Period issue can implicate the tax liability of a Target Entity for a Pre-Closing Tax Period. In other cases, the resolution of a dispute about a Straddle Period or Post-Closing Tax Period issue might involve adjustments to the tax liability of a Target Entity for a Pre-Closing Tax Period.

Typically, if a dispute related to the Straddle Period or a Post-Closing Tax Period has the potential to result in liability for Seller under its indemnification obligations for Pre-Closing Taxes, Seller will want some measure of participation or control. Accordingly, the parties may agree that Buyer will attempt in good faith to sever the dispute into (1) a contest related specifically to Pre-Closing Tax Periods (which will be subject to the provisions of the terms related to such contests) and (2) a contest related specifically to Post-Closing Tax Periods. Absent such a

severing, Seller will typically retain participation rights and/or consent rights that resemble those granted by Seller to Buyer with respect to Pre-Closing Tax Period contests.

E. Indemnification and Tax Benefit Offsets

The indemnity provisions are some of the most economically significant in the acquisition agreement. The extent to which Seller agrees to indemnify Buyer for certain items is a business-level discussion, but once a general agreement has been reached that Seller will have indemnification obligations as part of the deal, the devil is in the details: what will Seller indemnify? To what extent? How long will these obligations survive? How can Seller contest an indemnification claim?

From a tax perspective, there are generally two separate indemnification obligations to be aware of, notably indemnification for breach of representation or covenant and a "bright line" indemnity for Pre-Closing Taxes. The mechanisms for making indemnification claims against Seller and receiving reimbursement from Seller for each of these items may be different and involve distinct economic considerations.

1. Triggers

As a general matter, there must be a "Loss" for Buyer to seek indemnification from Seller. The definition of "Losses" is critical and is applicable to all claims for which Buyer may seek indemnification in the agreement, including those that are tax-related.

Sellers will generally seek to put a limit on how long claims for Losses relating to a breach may survive past closing. Buyer will typically seek special treatment for tax-related representations and covenants *vis-à-vis* other representations in the agreement, for example, the survival of tax reps for the applicable statute of limitations plus 30 to 90 days as opposed to the general survival period of six to 12 months.

Separate and apart from breach of representation or covenant is a potential "bright line" indemnity for Pre-Closing Taxes. The general principle for the Pre-Closing Tax indemnity is based on having Seller pay for the taxes that are attributable to its watch dollar-for-dollar.

Other provisions of the acquisition agreement will have a significant effect on the structure of the Pre-Closing Tax indemnity. The treatment of refunds, Post-Closing Tax Period covenants applicable to Buyer actions and other provisions may otherwise limit Seller's indemnification obligations.

2. Mechanisms and Limitations

The indemnification arrangement, including the Pre-Closing Tax indemnity, are heavily negotiated points and there may be circumstances in which separate tax items deserve unique considerations. There are, however, means by which all of Seller's indemnification obligations may be limited, either because the claim is too small, it is not material enough or the business principals have negotiated a ceiling on Seller's ultimate indemnification liabilities.

3. Tax Benefit Offset

Because the goal of the indemnity arrangement in general is to make Buyer whole for Losses attributable to risks attributable to Seller, Seller might negotiate that any indemnification claim (breach of representation, covenant or for Pre-Closing Taxes) be reduced by certain economic benefits Buyer receives related to the applicable Loss. This would include any net tax benefit that Buyer would realize—such as a deduction or credit—as a result of the incurrence or payment of any indemnifiable Loss. How the relevant tax benefit is determined is a matter of negotiation, including what Buyer tax benefits count and how the tax benefit is determined.

Here again there is an example of how the TCJA introduces a new dynamic with respect to the importance of certain deductions for certain taxpayers. The BEAT, as described further below in Part IV.B.2, places a U.S. corporation in an alternative tax system if its "base erosion payments" ("BEPs")—essentially deductible payments made by a U.S. entity to foreign affiliated entities—exceeds 3%[39] of all its allowable deductions.[40] For instance, deductible Losses paid by Buyer to an unrelated party are potentially beneficial for purposes of Buyer's BEAT exposure and could be construed as a tax benefit for purposes of determining Seller's indemnification obligations due to an increase in the denominator of the base erosion percentage.[41]

IV. TCJA Dynamics

The discussion above provides a general background and framework for a typical multi-jurisdiction acquisition where the parties negotiate to set expectations over tax consequences and the allocation of tax risk, and the key contractual terms by which they do so.

The focus now shifts to how the TCJA has accentuated and intensified certain negotiating dynamics, and perhaps changed how tax directors on both sides of the deal will need to brief their CFOs and business development

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teams. While some of the basic issues with respect to generally applicable tax provisions discussed above have not changed significantly as a result of the TCJA, the TCJA introduced new challenges and issues for both Buyer and Seller.

For example, the TCJA did not fundamentally alter how the parties would negotiate over process and payment of an indirect withholding tax levied by India or China, as discussed in Section III.B above. That is, the goal of these negotiations prior to the TJCA was to minimize incidence of these taxes and for each side to try to limit its exposure to risks to the maximum extent possible. After the TCJA, the incentives are the same. On the other hand, the TCJA did introduce extensive changes to the FTC regime.[42] Thus, Seller may be concerned that foreign taxes it pays in the deal—such as indirect withholding taxes levied by India or China—that might be subject to more onerous restrictions for purposes of claiming a U.S. FTC, and Buyer will be concerned with the availability of FTCs from Target Entities' and Target Subsidiaries' businesses in Post-Closing Tax Periods.

Similarly, if there is an audit of a transfer pricing issue with respect to transactions between a U.S. Target Entity and a foreign Target Entity, and Seller is providing an indemnity for Pre-Closing Taxes, the negotiating dynamics are unaffected in the sense that Seller will want to control the exam while Buyer will be concerned over ongoing consequences.[43]

There are, however, several areas where new issues created by the TCJA's changes will need to be forecasted and sorted out between the parties, whether in contractual terms or in post-closing cooperation.

A. Buyer Post-Closing Actions

There have always been situations where Buyer's actions or elections post-closing can have a material impact on Seller's Pre-Closing Tax liability. As discussed above, Seller may negotiate to constrain these actions through post-closing operating covenants in the agreement, such as restrictions on filing amended returns or making retroactive tax elections. As a result of the TCJA, these situations are likely more numerous in acquisitions of foreign Target Entities and those that already existed can have a more immediate and/or substantial impact on Seller.

1. Code Sec. 338 Elections

Sticking with the Base Case, prior to the passage of the TCJA, negotiations between the parties over Buyer's contractual right to make a Code Sec. 338 election with respect to a foreign Target Entity was always subject to some degree of potential controversy between the parties. As noted above, the election has several general consequences including:

- Inclusion of the foreign Target Entity's deemed sale gain during the Seller's holding period for U.S. federal income tax purposes[44];
- The closing of the foreign Target Entity's tax year[45];
- Buyer inheriting what is essentially a new corporation with respect to U.S. tax attributes of the foreign Target Entity[46]; and
- Buyer benefitting from a basis step-up and resulting amortization.[47]

Often the parties would look at the benefit of the Code Sec. 338 election on both sides as going beyond specific tax accounting consequences,[48] and consider the certainty of year closure and the purging of the tax attribute history of the Target Entity. This certainty was in the form of making sure Buyer's actions in a Post-Closing Tax Period would not impact Seller's expected tax treatment for Code Sec. 951(a) or FTC purposes, which could be the case if no election were made and the tax year remained open. The elimination of these issues through an election, subject to Code Sec. 901(m), also provided Buyer's tax department a fresh start for records purposes. These consequences have not changed under the TCJA.

While there were certainly exceptions, pre-TCJA, the consequences, benefits and detriments of the election largely depended on a host of hypotheticals. That is, "what if" Seller's deemed sale gain produced Subpart F income[49] or potentially diluted FTCs[50] and "what if" the step-up produced deductions that shelter Subpart F income of Buyer in a Post-Closing Tax Period? Also, notably, in the absence of a Code Sec. 338 election, "what if" Buyer's post-closing actions during the Straddle Period might impact Seller's Subpart F income, Code Sec. 1248 deemed dividends or former Code Sec. 902 consequences?[51]

Under the TCJA, a Code Sec. 338(g) election likely has a more immediate and consequential impact to both Buyer and Seller. With the introduction of GILTI into the U.S. international tax system, gain on the deemed sale of assets by a CFC has the substantial likelihood of resulting in immediate tax consequences to Seller. Absent being treated as Subpart F income, the deemed sale gain will likely be considered tested income under Code Sec. 951A, potentially resulting in an additional GILTI inclusion on a U.S. Seller (depending on the other components of the GILTI calculation such as tested losses and QBAI[52] under Code Sec. 951A). If the Seller's CFC group has a tested loss (whether related or unrelated to the sale), Seller may be able to offset any tested income

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from the deemed sale gain. Seller may additionally have FTCs that can offset the incremental GILTI inclusion, though not completely due to the limitations built into Code Sec. 960 and Code Sec. 904(d). In general, potential FTC sheltered GILTI income may be preferable to capital gain taxed at 21% to Seller.

If Buyer is a U.S. parented group, it will likely view the Code Sec. 338(g) election as a definite and quantifiable benefit. Buyer's GILTI consequences going forward will likely benefit from an increase in QBAI and additional Code Sec. 197 amortization deductions, and any E&P from the relevant CFC Target Entities is purged as a result of the election, benefitting a U.S. Buyer that would otherwise have a GILTI inclusion at the end of the year as a result.[53]

Prior to the TCJA, the discussion of the advantages and disadvantages on each side was nuanced, complex and, as noted, based on a variety of "what ifs" (as were the potential disputes between tax experts of Buyer and Seller). This often made translating these technical issues from tax jargon into more natural language in order to convey to the business teams extremely difficult. Post-TCJA, the issues and dynamics related to the Code Sec. 338(g) election might, at least, be easier to convey to the business teams, as the general tax consequences of the election are now more consistent with what many in the business development world have generally known for years. That is, selling assets can produce more income and potentially more tax than selling stock, while buying assets can give a step-up in basis and more amortization deductions going forward. So, in that sense, putting aside all the other complexities of TCJA and the GILTI regime, it might be easier for tax experts to convey to CFOs and business development teams the benefits and downsides to the Code Sec. 338(g) election.

The potential for a Code Sec. 338(g) election was always a subject for both Buyer and Seller to discuss in the context of negotiating covenants applicable to Post-Closing Tax Periods that would otherwise restrict Buyer from making the election, as discussed in Part III.D.2 above. The TCJA may create more situations in which Seller and Buyer in the Base Case both prefer a Code Sec. 338(g) election. This dynamic is made more complex from a business negotiation standpoint, though, due to the fact that GILTI operates on an aggregate basis across all CFCs in an entire group for each side. That is, Seller might present the election as a cost due to the tested income result and stress that Buyer will get a clear and immediate benefit moving forward. Buyer, on the other hand, may or may not benefit from the basis step-up, depending on all of the other factors that go into Buyer's worldwide GILTI calculations. Because tested income, tested loss, QBAI, FTC and interest expense variables on each side's group structure shift these assumptions, both sides will have difficulty looking into the other's complete tax consequences from the election.

2. Code Sec. 965

Although the Code Sec. 965 transition tax is, in a sense, old news, for many taxpayers, its shadow will continue to linger through the 2025 tax year, especially in the M&A and IRS examination worlds. Many U.S. corporations that had liability under Code Sec. 965 elected under Code Sec. 965(h) to pay the transition tax liability in annual installments over an eight-year period, each installment increasing as a percentage of the total liability after 2022.[54] Buyers of U.S. Target Entities that owned CFCs not only have the significant task of conducting M&A diligence on this embedded liability, but may also assume the legal obligation to pay it in Post-Closing Tax Periods, including perhaps the joint and several liability that goes with a former member of an affiliated group filing a consolidated tax return.[55]

There are several issues with regard to Code Sec. 965 and the continuing liability for what was a Subpart F inclusion under Code Sec. 951(a) for the 2017 tax year. Focusing on the Base Case again, in which there is an acquisition of a U.S. Target Entity out of a U.S. affiliated group of Seller (but also noting that different points can arise in other deal structures, such as where Buyer acquires a standalone U.S. company rather than an affiliate of a consolidated group), these are:

- As a contractual matter, determining which side will assume the Code Sec. 965 liability for future installment payments;
- If Buyer is taking on the Code Sec. 965 liability allocable only to those U.S. Seller Affiliates which Buyer is acquiring,[56] determining how Buyer will protect itself from Code Sec. 965 liability, including joint and several liability of Seller's group under Reg. §1.1502-6 with respect to the Code Sec. 965 liability attributable to other members in Seller's group that Buyer is not acquiring;
- Whether the U.S. Target Entity constitutes "substantially all" of the assets of the Seller group, potentially causing an acceleration of the Seller group's overall Code Sec. 965 liability[57]; and
- Determining the consequences of an acceleration of a Code Sec. 965 liability on either side for non-compliance or certain other issues, as discussed below, and who bears those consequences as under the agreement.

The Code Sec. 965 amount is a tax for the 2017 tax year, and thus it may be covered under the Pre-Closing Tax indemnity and with respect to the type of tax rep noted in Part III.C.5.b above, though a better approach is for the parties to put more precision around the language allocating (1) the Code Sec. 965 liability which is known and (2) any Code Sec. 965 liability which is unknown or triggered under the rules discussed below.

As a general matter, the Code Sec. 965 amount is a separate tax payable by a U.S. shareholder of a CFC with accumulated post-1986 earnings and profits, as defined in Code Sec. 965(d)(2).[58] The total liability under Code Sec. 965 can be paid in eight annual installments following an election under Code Sec. 965(h).

There are a number of Code Sec. 965 related considerations applicable to consolidated groups. Generally, the Code Sec. 965 liability was calculated as a tax in the 2017 tax year on a group basis across CFCs held by the group and took into account the aggregate foreign cash position,[59] E&P net deficits[60] and Code Sec. 965(c) deductions[61] of the group. Each member of the U.S. consolidated group that was a Code Sec. 958(a) shareholder of a CFC had a separate Code Sec. 965 amount, though E&P net deficits that were included in the group's overall Code Sec. 965 calculation are allocated across each U.S. corporate group member with an E&P net surplus from any CFCs for which it was a Code Sec. 958(a) shareholder.[62] Key elections regarding the Code Sec. 965 liability are made at the consolidated group level on behalf of all members of the group.[63] Ultimately, primary legal liability for purposes of the consolidated return regulations was not changed, and the individual U.S. member's Code Sec. 965 liability rests with the parent, but is still subject to the rules concerning joint and several liability.[64]

With respect to the Code Sec. 965(h) installment payments, certain events in Post-Closing Tax Periods can cause all installment payments otherwise due to be accelerated and payable on the date the acceleration event occurs. There is a litany of acceleration events in the statute and regulations and associated exceptions, but the primary acceleration events that can arise in the case of an acquisition of a U.S. Target Entity include:

- Failure to timely pay an installment payment[65];
- Liquidation, sale, exchange or other disposition of substantially all of the assets of the U.S. Target Entity[66]; or
- Cessation of business.[67]

There are a number of exceptions to immediate acceleration, but generally in the case of a disposition of substantially all of the assets of a U.S. corporation with a Code Sec. 965(a) inclusion, the transferor and transferee are required to enter into a transfer agreement meeting certain conditions, including requiring the transferee to assume the liability for the Code Sec. 965(h) installment payments after the disposition, and file the agreement with the IRS within 30 days of the transaction.[68] If these elements are not met, the entire transition tax liability becomes due on the date of the disposition.

There are at least three scenarios to consider in allocating the risk of a lingering Code Sec. 965 liability, each of which demonstrate the increased attention to negotiating post-closing risk in respect of tax matters in an acquisition agreement brought about by the TCJA and Code Sec. 965.

First, consider the Base Case where Seller, the parent of a consolidated group that includes U.S. Target Entity, sells U.S. Target Entity and U.S. Target Entity does not constitute "substantially all" of the Seller's assets on a consolidated basis.[69] Then, in a Post-Closing Tax Period, Seller misses a Code Sec. 965(h) installment for the group's Code Sec. 965 inclusion, thus accelerating the entire Code Sec. 965 liability such that it is due as of the date of the missed payment.[70] It would appear that, although the acceleration of the total Code Sec. 965 liability occurs in a Post-Closing Tax Period, the total amount due is a tax with respect to the 2017 tax year.[71] If it is the case that the acceleration is interpreted to mean it is a tax for 2017 tax year due on the date of the missed payment, U.S. Target Entity is potentially jointly and severally liable for the Seller group's total Code Sec. 965 liability because it is a tax with respect to the 2017 tax year (when U.S. Target Entity was a member of the group), and thus U.S. Target Entity might otherwise be liable to pay the entire Code Sec. 965 amount as a legal matter.[72]

Second, assume again the Base Case where Seller is the parent of a consolidated group that includes U.S. Target Entity, Seller sells U.S. Target Entity and U.S. Target Entity does not constitute "substantially all" of the Seller's assets on a consolidated basis. Further assume that the IRS determines in 2020 there is a deficiency in the amount included in Seller's income under Code Sec. 965 in the 2017 tax year. As a result, Seller would have underpaid prior Code Sec. 965 installment payments up to 2020. The Code Sec. 965 regulations operate such that where a Code Sec. 965(h) election is made, the Seller will pay the deficiency to the total Code Sec. 965 liability by allocating the amount of the deficiency over the remaining installment payments instead of paying that amount as a lump-sum adjustment to the prior installment payments.[73] Seller remains liable for the increased installment payments in subsequent years, and again U.S. Target Entity is potentially jointly and severally liable for those amounts, including any amount not attributable to the U.S. Target Entity or its subsidiaries.

Finally, consider the situation where U.S. Target Entity becomes an expatriated entity under Code Sec. 7874 in a Post-Closing Tax Period. If a Code Sec. 958(a) U.S. shareholder included an amount in income under Code Sec. 965 and becomes an expatriated entity under Code Sec. 7874(a)(2) in the 10-year time period after December 22, 2017, the Code Sec. 965 liability is increased in the year in which it becomes an expatriated entity by 35% of any deduction that the U.S. shareholder had been allowed under Code Sec. 965(c) and a denial of any FTCs to offset the increased amount.[74]

Code Sec. 965(l) states that this increased liability is due in the tax year in which the U.S. shareholder becomes an expatriated entity, which in our example would occur in a Post-Closing Tax Period when U.S. Target Entity is no longer a member of the Seller consolidated group. Code Sec. 965(l), though somewhat ambiguous, indicates that this additional tax under Code Sec. 965(l) is not attributable to the 2017 tax year but rather the year in which the U.S. Target Entity becomes an expatriated entity.[75] This ambiguity will likely raise issues under the acquisition agreement and general indemnity arrangement unless it is addressed in specific drafting. If it were the case that the Code Sec. 965(l) amount is a tax attributable to the 2017 tax year, this amount would be a tax for which Seller is legally responsible as the parent for the consolidated group that U.S. Target Entity may be jointly and severally liable for. If, however, the Code Sec. 965(l) amount were a tax in a post-2017 tax year, Seller would generally not be legally liable to pay and instead that amount would be the U.S. Target Entity's, and hence Buyer's, legal responsibility. Of course, this begs the question of how the parties would allocate this tax in the agreement.

There is an additional question regarding the reach of Code Sec. 7874(a)(2)(ii) and Code Sec. 965(l). For example, assume Buyer in a Post-Closing Tax Period transaction completely unrelated to its deal with Seller, acquires all of the outstanding stock of a U.S. corporation treated as an expatriated entity under Code Sec. 7874(a)(2) (such corporation, "New Target"). In that case, there is an issue as to whether U.S. Target Entity—now an affiliate of New Target—should be treated as an expatriated entity under Code Sec. 7874(a)(2)(ii) due to the "radioactivity" of New Target's expatriated entity status and U.S. Target Entity's relatedness to New Target.[76] It would seem inconsistent with the policy goals of Code Sec. 965 for that relatedness to cause a Code Sec. 965(l) recapture event for U.S. Target Entity, and even more so of an inconsistent policy with regard to somehow extrapolating that to a Code Sec. 965(l) problem for Seller.

3. Foreign Tax Adjustment of Foreign Target Entities

The repeal of Code Sec. 902 and the increasing limitations on the use of FTCs raise issues with respect to post-closing audits and adjustments of Pre-Closing Tax Periods of a foreign Target Entity. For instance, if a foreign taxing authority audits a foreign Target Entity for a Pre-Closing Tax Period, any pre-closing foreign tax adjustment attributable to, for example, the 2016 and 2017 tax years would be subject to the pre-TCJA FTC regime, likely requiring the filing of an amended return rather than making any forward-looking adjustments under the FTC regime introduced by the TCJA.

If there is an adjustment to foreign taxes with respect to a foreign Target Entity for a Pre-Closing Tax Period, it will likely result in a redetermination in U.S. tax for the "year or years affected."[77] As a result, the U.S. tax due for the year affected will potentially be adjusted through a change in allowance of FTCs, with the possibility of a corresponding U.S. federal refund or credit to Seller.[78]

Assume, for example, that one of the Target Entities was a U.S. affiliate that owned a German CFC at closing, and the German tax authority examines the CFC for the 2016–2017 cycle with the result being an adjustment to German corporate taxes due. If there were no Subpart F inclusions or actual dividends during that period, the redetermination would likely impact the Seller group's allowable FTCs with respect to its Code Sec. 965 inclusion in 2017. If there is a decrease in foreign taxes for a Pre-Closing Tax Period, the U.S. tax liability for the year or years affected could increase, due to the potential loss of allowable FTCs for that period. If this redetermination occurred with respect to a foreign Target Subsidiary and affected any year prior to 2018, for example, further adjustments would need to be made under the Code Sec. 902 deemed-paid FTC regime up to the 2017 year with respect to the Target Entity and ultimately Seller.[79]

Either of these situations could have an effect on the Code Sec. 965 liability of the prior U.S. shareholder of that foreign Target Entity.[80] If foreign taxes are decreased, for instance, or if there is a foreign tax refund, FTCs that may have offset any Code Sec. 965 inclusion may need to be adjusted as well. Note also that Code Sec. 965(k) extends the statute of limitations for assessment of the net Code Sec. 965 tax liability to six years after the return for the Code Sec. 965 inclusion was filed notwithstanding the general three-year rule in Code Sec. 6501.

Again, with respect to an exam and tax adjustment by a foreign taxing authority with respect to a Pre-Closing Tax Period, any potential scenario that was an

issue before TCJA has likely become more challenging, as whatever adjustment is made during a post-2017 exam will need to be analyzed under the new rules of Code Sec. 905, in the context of a world without Code Sec. 902, and with the new, and generally more restrictive, baskets under Code Sec. 904(d) for GILTI and foreign branch income. Redeterminations to pre-2018 tax years, though, might require amending pre-2018 tax returns and applying the old Code Sec. 902 regime due to the repeal of forward looking pooling adjustments under former Code Sec. 905(c)(1). As noted, the relevant pre-2018 adjustment could impact the Code Sec. 965 liability of the Seller's group, which Buyer may have inherited depending on the issues outlined in Part IV.A.2 above. When all of these factors are put into the melting pot of a large corporate tax return, different results can occur as to the generation and timing of FTCs and their potential utilization. In some cases, the result could even be an excess credit for the U.S. Seller group for pre-2018 years, part of which carries over to Buyer through the purchase of the U.S. Target Entity that owned the CFCs subject to the foreign tax adjustment.[81] Moreover, the limits on Buyer's ability to utilize any FTC will likely impact how the parties view the economics of any Seller indemnity for purposes of a tax benefit offset discussed in Part III.E.3 above.

B. Inheriting Tax Attributes and Other Tax Characteristics

Tax attributes range from tax basis to various types of credits, NOLs and other items that may not be accrued in a sense of being carryforward items, but rather constitute what are essentially characteristics of the relevant Target Entity, group or overall business operations. The TCJA has both changed and added considerations related to the tax attributes and structure that Buyer will inherit in certain cases, particularly where the Base Case includes the acquisition of CFC Target Entities for which there is no Code Sec. 338 election or a U.S. Target Entity that owns CFC Target Subsidiaries for which there is no Code Sec. 338(h)(10) election with respect to the acquisition of the U.S. Target Entity.[82] There are more attributes and characteristics, which again can result in more immediate traps (and opportunities) for Buyer.

1. PTI Consequences

Amounts included as income under the Code Sec. 965 transition tax are, generally speaking, treated as PTI under Code Sec. 959 by virtue of their classification as Subpart F Income.[83] The relatively quick creation of a large amount of PTI in the tax attributes of U.S. based multinationals such as Seller in the Base Case as a result of Code Sec. 965 transition tax has amplified the relevance of issues related to PTI. These include those issues embedded in the PTI calculations relating to FTCs, foreign currency gain or loss, and tax basis in first-tier CFC Target Entities and lower-tier CFC Target Subsidiaries.

The enhanced PTI pools result in more frequent application of the old pre-TCJA rules governing PTI and some new issues with respect to the effect of PTI distributions on a U.S. Target Entity's basis in shares of CFC Target Subsidiaries. For example, assume that a U.S. Target Entity directly owns Target Subsidiary 1 and Target Subsidiary 2, both of which are and were CFCs on the Code Sec. 965 inclusion date. Target Subsidiary 1 was a deferred foreign income corporation under Reg. §1.965-1(f)(17), and Target Subsidiary 2 was an E&P deficit foreign corporation under Reg. §1.965-1(f)(22).

The amount of the Code Sec. 965(b) aggregate Target Subsidiary 2 deficit in post-1986 E&P reduced what otherwise would have been the U.S. Target Entity's Code Sec. 965(a) inclusion amount and was treated as an amount included in income under Code Sec. 951(a) for purposes of applying Code Sec. 959 with respect to Target Subsidiary 1.[84] That means that distributions of Target Subsidiary 1's accumulated post-1986 deferred foreign income not included in the U.S. Target Entity's Code Sec. 965(a) inclusion amount by virtue of Code Sec. 965(b) will reduce the U.S. Target Entity's basis in Target Subsidiary 1 under Code Sec. 961(b) similar to the treatment of other distributions of PTI. If the Seller group made an election under Reg. §1.965-2(f)(2), the Code Sec. 965(b) aggregate foreign E&P deficit treated as PTI under Code Sec. 965(b)(4)(A) would increase the U.S. Target Entity's basis in Target Subsidiary 1. However, the Code Sec. 965(b) aggregate foreign E&P deficit would reduce the U.S. Target Entity's basis in Target Subsidiary 2.

With the Code Sec. 965 transition tax and the broad reach of GILTI under Code Sec. 951A, the TCJA creates more basis adjustments of CFC stock under Code Sec. 961. Although Code Sec. 961 basis adjustments are nothing new, the TCJA makes them more frequent, and as a result, IRS examinations and adjustments for Pre-Closing Tax Periods are more likely to result in corollary basis adjustments that can impact Post-Closing Tax Periods.

2. Base Erosion and Anti-Abuse Tax

The TCJA created a new tax on corporations in Code Sec. 59A—the BEAT. Under the BEAT, a domestic corporation with average annual gross receipts of $500 million

or more that makes BEPs constituting 3% or more of its total annual deductions must pay a minimum tax.[85] Under Code Sec. 59A(d)(1), BEPs are defined broadly to include any deductible amounts paid or accrued by a taxpayer to a foreign related party.[86]

In the Base Case, even where a Code Sec. 338(g) election is made, Buyer is inheriting what is likely an established system of payments among the U.S. and foreign Target Entities and Target Subsidiaries for intercompany services and other deductible items, which might well be classified as BEPs.

The BEAT also may change the negotiating dynamics of certain provisions in the general indemnification arrangement. As discussed in Part III.E.3, Seller may sometimes negotiate to offset certain tax benefits Buyer may receive from incurring an indemnifiable Loss against Seller's general indemnification obligations to Buyer. If Buyer accelerates a deduction which produces an indemnifiable Loss and increases the denominator of the BEAT percentage to such an extent where Buyer is no longer subject to BEAT, should Seller be able to offset its indemnity obligations by the benefit Buyer receives from avoiding the BEAT tripwire? Because BEAT may incentivize accelerating deductible payments to unrelated parties, and restructuring items to make them non-related party payments, BEAT may create more contentious negotiations between Buyer and Seller over the tax benefit offset provision depending on the BEAT profile of Buyer and Seller.

Moreover, there may be situations where Seller has taken the positon that it met the services cost method exception under the definition of BEPs in accordance with Proposed Reg. §1.59A-3(b)(3)(i) for payments to service providers that are foreign affiliates. Under that exception, deductible arm's-length payments to foreign affiliates that meet certain requirements under Reg. §1.482-9(b) and are eligible to apply the services cost method for transfer pricing purposes are otherwise excluded from the numerator of the BEAT percentage.[87] If it is ultimately determined that Seller, for example, did not meet this exception for payments made in a Pre-Closing Tax Period, the payment might then constitute a BEP for that earlier tax period, which may also require additional adjustments in a Post-Closing Tax Period. As noted, Buyer will be inheriting that payment system, and Buyer will need to determine whether Seller's previous reliance was warranted, both for purposes of any liability Buyer takes on as a result of an incomplete indemnity, and in the case of Buyer's ongoing operations and exposure to BEAT in Post-Closing Tax Periods.[88]

Both Buyer and Seller must incorporate the BEAT into the diligence process and how the acquisition and divestment, respectively, of an established payment system will interact with existing or remaining factors which go into the BEAT numerator and denominator. Like so many of the TCJA's changes, this will come down to a modeling exercise as to what the "BEAT-able payments" are before and after the deal on each side, and the overall impact on each side's BEAT posture going forward.

3. Code Sec. 163(j)

New Code Sec. 163(j) replaced the old earnings stripping rules with a significantly broader application. The resulting limitation on the deductibility of net business interest expense under the new Code Sec. 163(j) is 30% of a taxpayer's adjusted taxable income, regardless of whether the debt is between related parties, how the entities are classified for U.S. federal income tax purposes or the capitalization of the entities.[89] Depending on Buyer's leverage before and after Closing, Buyer may be able to optimize its tax planning by making acquisitions that will afford it increased interest deductions and limitations.

New Code Sec. 163(j) has also changed the tax attributes that Buyer stands to inherit as the result of an acquisition of a Target Entity. First, both old Code Sec. 163(j)(1)(B) and new Code Sec. 163(j)(2) permit an indefinite carryforward of Target Entity interest expense for which a deduction was disallowed under the section. Pre-TCJA, the ability to use those carry-forward deductions in a particular subsequent year was limited by an amount equal to the excess of 50% of its adjusted taxable income over its interest expense, such amount defined as a taxpayer's excess limitation.[90] Excess limitation for a particular year that was not used to permit a deduction of excess interest expense could be carried forward three years.[91] New Code Sec. 163(j) bases the amount of disallowed interest deductions on an amount equal to 30% of the taxpayer's adjusted taxable income.[92] New Code Sec. 163(j) does not allow a carryforward of excess limitation but preserves the ability to carryforward disallowed deductions, and use those deduction against any excess limitation generated in the carryforward year.[93]

Treasury has issued proposed regulations that cover, among other things, how new Code Sec. 163(j) will treat interest expense disallowed as a deduction under old Code Sec. 163(j).[94] Indeed, certain disallowed interest under former Code Sec. 163(j) is generally treated as a disallowed business interest expense under new Code Sec. 163(j) and carried forward indefinitely under these proposed regulations.[95] However, no amount of excess limitation under former Code Sec. 163(j) may be carried forward to tax years beginning after December 31, 2017.[96]

With respect to new Code Sec. 163(j), under recently proposed Treasury Regulations, Code Sec. 163(j)(2) carryforwards would be treated similarly to other corporate attributes when a Target Entity leaves the Seller consolidated group. In general, all members of a consolidated group are treated as a single entity for purposes of calculating the group's Code Sec. 163(j) limitation.[97] When the Target Entity leaves the Seller group, the Target Entity's business interest expense and any Code Sec. 163(j)(2) carryforwards from prior years must be used in the consolidated return year to the extent those deductions can offset available consolidated taxable income.[98] Once the Target Entity leaves the group, the availability of any excess Code Sec. 163(j)(2) carryforwards is subject to the separate return limitation rules under Reg. §1.1502-21(c).[99]

All in all, new Code Sec. 163(j) adds to the tax attribute profile of the U.S. Target Entity and potential post-acquisition tax planning for Buyer. This is another example of tax accounting items for adjustments for Pre-Closing Tax Periods impacting the attributes Buyer inherits in the deal.

C. Post-Closing Dynamics Post-TCJA

Above are just a handful of examples as to how the TCJA intensified issues concerning post-closing actions that can affect each of the parties, the enhanced attributes and characteristics of the Target Entities and why post-closing interactions among the parties to a deal may be more common post-TCJA. There are certainly more scenarios where both parties will have a greater stake in examinations in a Post-Closing Tax Period, requiring thoughtful drafting in the acquisition agreement, identifying new risks and allocating them among the parties to the deal. Once the transactional lawyers have agreed to a deal, each side needs to think how their respective tax controversy teams will be working together moving forward.

V. Tax Controversy Dynamics

A. Practicalities of Joint Control over Audits

Buyer and Seller will likely each have interests in sharing control of tax contests, particularly those involving Pre-Closing Tax Periods and Straddle Periods. An audit by a taxing authority for these periods could well impact both parties' interests, perhaps in an opposite manner, and such an audit may already be in process on the Closing Date or may arise thereafter. The dynamics of new provisions in the TCJA increase the likelihood that Buyer and Seller will have more to fight about, but at the same time more to coordinate, over the post-closing scrutiny of tax authorities. Part III.D.5 above addresses how the parties can anticipate and plan for effective coordination of tax contests. Part IV above addresses ways in which cross-border aspects of the TCJA portend audit sensitivities for both Buyer and Seller concerning the sharing of tax risks, with respect to both tax assessments and attributes. In addition to necessary drafting for tax procedures in the agreements, it is important to understand the practical considerations that arise when Buyer and Seller must coordinate the management of a tax controversy.

Regardless of the private contractual arrangements governing control, review, participation and settlement rights, the taxing authority will generally recognize and interact with the designated representative of the taxpayer whose tax return is under scrutiny (*e.g.*, Buyer as current owner of the Target Entity under examination, even where Seller's indemnification obligations may be triggered by an adjustment affecting Pre-Closing Taxes). Actual face-to-face participation of any other interested party, even with the taxpayer's consent, can be complicated and resisted by the taxing authority.

In the context of an IRS examination, this may lead to disagreements about who actually appears on a Form 2848 Power of Attorney and interfaces directly with the examiners. Even if Seller has the right to control the dispute, can Seller compel Buyer to list Seller's representative on the Form 2848, thus authorizing Seller's representative to communicate directly with the IRS on behalf of Buyer? Is this a more practical solution than behind-the-scenes cooperation between Buyer and Seller's representatives? What if Seller's representative is *not* listed on the Form 2848, meaning that the IRS will interact directly only with Buyer's representative, even though Seller has exercised its contractual right to control the dispute? In that case, all IRS correspondence related to the dispute, including all Information Document Requests ("IDRs"), will go to Buyer's representative, and Buyer will deliver responses. How does Seller ensure that it receives copies with enough time to consider and influence the response? How will disputes over content be resolved? Although the provisions related to control over tax disputes may grant Seller a private cause of action if Buyer fails to coordinate with Seller in a timely fashion, on balance, Seller would almost certainly prefer to have the correspondence in time to meaningfully participate in preparing the response.

A similar problem could exist with respect to Seller's ability to implement strategic decision-making in the dispute, for example, involving decisions to take an administrative appeal, to litigate, or to enter into a closing agreement. How will adequate notice and consent be implemented and whose view will control? Buyer and Seller may want to negotiate and document in advance Seller's rights of approval over or direction of strategic actions Buyer takes, such as making IDR responses and document productions, filing a protest to a notice of proposed adjustment, entering into a closing agreement, or initiating litigation. This type of documentation might also provide Buyer with protection against breach of contract claims related to control over tax disputes, which Seller might use to offset any indemnity arising from the resolution of the dispute or as a free-standing claim. For practical purposes, advance (and regular) coordination when an audit commences will allow the parties to set expectations and establish processes to provide for the smoothest functioning of a dispute in which both parties have an interest.[100]

Most coordination in jointly controlled disputes is done behind the scenes between the parties and their representatives. As a result, Buyer, Seller and their respective tax professionals may have to coordinate over responding to relevant requests for information, documents and testimony, assertions of privilege, settlement negotiations and any ultimate litigation of tax controversies. As noted above, this process could require mutual cooperation between Buyer and Seller across several years in the normal course and for a decade or more if a disputed issue is ultimately resolved in the courts. Maintaining a relationship of cooperation over time could be critical to resolving tax contests in a mutually satisfactory way.

During the examination stage, the parties should understand their rights and responsibilities from the outset as dictated by the acquisition agreement, and establish procedures for identifying issues of shared interest and for information-sharing and cooperation in responding to inquiries from the taxing authority. Note that relevant background documentation and witnesses may be under the control of Seller, even where Buyer interfaces directly with the taxing authority. At a minimum, even if all goes smoothly, this process requires that sufficient time be built into the audit schedule to allow for notice, review and comment by the interested party who is not directly controlling the examination.

In negotiating resolutions, each party should have staked a claim with respect to the exercise of settlement rights in a tax controversy in which they have an interest. The other party must respect those consent and participation rights. Not surprisingly, potential claims between the parties may arise in the context of jointly managed tax contests if mutual cooperation provisions are breached or if unanticipated or negative tax consequences arise for an interested party.

B. Preserving Privilege in Transactional Planning and Joint Participation in Tax Disputes

A variety of protections may apply to legal advice received during the planning stages of a transaction and requests for such advice. The attorney-client privilege, the Code Sec. 7525 federal tax practitioner privilege (which applies the attorney-client privilege to certain non-attorneys in non-criminal, non-tax shelter, U.S. federal tax proceedings) and attorney-work product protection are among the most identifiable. Combining knowledge of the potential scope of privilege and confidentiality rules with thoughtful planning can help protect sensitive transaction-related communications from becoming subject to disclosure in any subsequent administrative dispute or litigation.

GILTI, potential Code Sec. 965 transition tax exposure and the BEAT, just to name a few, each have complicated cross-border deal dynamics in such a way that disputes between Buyer and Seller post-closing may be more commonplace post-TCJA.

Confidentiality is a cornerstone of the attorney-client privilege (and, relatedly, the Code Sec. 7525 privilege), and voluntary disclosure of an otherwise privileged document to someone who was neither the client nor the attorney will likely waive the privilege. How might this come up? In deal negotiations between Buyer and Seller, Seller discloses an aggressive reporting position with respect to a prior transaction involving a Target Entity. Buyer requests documentation supporting the treatment as part of the deal diligence and Seller discloses

an otherwise privileged opinion from Seller's tax lawyer about the U.S. federal income tax consequences of the transaction. Seller originally requested the opinion in its own capacity as a separate corporate entity from the Target Entity. Alternatively, imagine that the IRS undertakes an examination of the Target Entity after closing and, regardless of who controls the dispute, Seller provides that opinion to Buyer pursuant to the cooperation and information sharing provisions of the acquisition agreement.

Will either of those disclosures waive the attorney-client privilege with respect to the opinion? Maybe, maybe not. The common interest privilege may operate as an exception to prevent the waiver. Generally, the common interest privilege allows different attorneys representing different clients with similar or identical legal interests to share information with each other, without waiving the attorney-client privilege over the communications.[101] The test for the privilege varies among jurisdictions and is highly fact dependent, and its application to information shared between transactional parties in the context of transactions such as mergers or sales has been inconsistent.[102] Some jurisdictions have applied it in those contexts, but other jurisdictions regard transactional parties in mergers and sales as necessarily "adverse," precluding application of the common interest privilege.[103]

Note with respect to the IRS examination scenario, in many cases, the assertion of penalties will materially affect the decision about whether to make a voluntary disclosure of a tax opinion to the IRS. A well-supported, reasoned opinion is usually an essential component of a successful penalty defense.

C. International Issues Related to Privileges and Protections

We are in a world of increasing tax compliance activity and information sharing, both domestically and abroad. Domestically, the last 10 years have seen FATCA,[104] voluntary compliance programs by federal and state governments, and LB&I's recent campaign-based compliance initiatives[105] (now numbering over 50). Internationally, country-by-country reporting, multilateral and cross-border audits, and new, more comprehensive (and compulsory) information exchange regimes are part of the trend.[106] Accordingly, another area of concern with respect to privilege relates to examinations by non-U.S. taxing authorities where information is turned over which may have otherwise been protected by a privilege with respect to the IRS.

For example, suppose that the Indian taxing authority opens an examination of Seller related to tax on an indirect transfer of shares in an Indian Target Subsidiary. As part of that examination, the Indian taxing authority requests certain documents. Among the responsive documents in Seller's possession is a copy of a document containing sensitive information prepared by Seller for a Big Four accounting firm as part of a request for an opinion analyzing certain U.S. federal income tax consequences of the transaction.

That document might otherwise be protected by the Code Sec. 7525 privilege in the United States. However, such protection is entirely statutory under U.S. law, and an equivalent privilege does not exist in many other jurisdictions. Turning the document over to the Indian taxing authority, though, may constitute a voluntary disclosure that would waive the Code Sec. 7525 privilege. What should Seller do? First, Seller may want to evaluate whether it may be possible for Seller to assert the Code Sec. 7525 privilege under any applicable treaty. Prime candidates would be the Hague Evidence Convention, and, of course, Article 28 of the tax treaty between the United States and India, particularly if the Indian taxing authority requests the assistance of the IRS in obtaining the document from Seller. Second, Seller may be able to negotiate an exercise of comity by the Indian taxing authority regarding the Code Sec. 7525 privilege. Finally, in the event that Seller is unsuccessful in any of those efforts, Seller should take reasonable steps to protect the confidentiality of the document, which, under certain circumstances, might include withholding the document until the point of judicial compulsion and filing it under seal.

VI. Conclusion

The long, drawn out process of fundamental tax reform had perhaps caused a pause in the M&A pace through 2017 and 2018, as companies sorted out the consequences. With the deal pace picking up in 2019, we are seeing the consequences of reform, including much of the old playbook for negotiation of tax issues, but certainly some new issues and dynamics. A reasonable conclusion at this point is that there are more issues for both sides to think about and probably more reasons for tax planners to consider how the two sides, and their controversy teams, will interact post-closing. GILTI, potential Code Sec. 965 transition tax exposure and the BEAT, just to name a few, each have complicated cross-border deal dynamics in such a way that

disputes between Buyer and Seller post-closing may be more commonplace post-TCJA. While the deal planners might have a few short weeks to sign up a deal, chances are that post-closing issues will have the two sides dealing with each other for considerably longer periods.

ENDNOTES

* The authors wish to thank Sean M. Fitzgerald for his comments and assistance on this article.

1 Unless otherwise indicated, section or "§" references are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

2 Provisions about the allocation of purchase price may also fall under the broad category of payment terms.

3 As discussed in Part III.C.5.a below, mid-year Subpart F or GILTI may demand specific treatment as a working capital adjustment, as such inclusions under Code Sec. 951 or Code Sec. 951A generally do not accrue until the end of the CFC's tax year. Code Sec. 951(a)(1); Code Sec. 951A(e)(2).

4 Broadly, an earnout provision specifies payments from Buyer to Seller if the target achieves certain benchmarks, for example, a revenue or earnings goal, within a certain period of time after the Closing Date. Earnouts are common features in many deals—especially those involving targets that have some form of promising IP, such as in the pharmaceutical industry. While beyond the scope of this article, the structure of earnout payments has U.S. federal income tax consequences that Buyer and Seller should consider.

5 TJCA §14301 repealed the Code Sec. 902 deemed paid FTC regime for 10% owned foreign corporations, for example. Further, the deemed paid credit for inclusions under Code Sec. 951A under Code Sec. 960(d)(1) is limited to 80% of the applicable foreign taxes. Other FTC restrictions are typically driven by limitation basket rules and the allocation of expenses for purposes of determining the relevant Code Sec. 904(d) limitation basket for FTCs allocable to certain inclusions. For example, *see* Proposed Reg. §1.861-8, FR Vol. 71, No. 150B, at 44,247 (preamble to proposed FTC regulations requiring full allocation of U.S. shareholder level expenses to the Code Sec. 951A limitation basket under Code Sec. 904(d)(1)(A)).

Following the amendments by TJCA §14201(b) and §14302, there are now four separate limitation baskets for FTCs—passive, active, GILTI and foreign branch income. Under Code Sec. 904(d)(2)(J), "foreign branch income" means the business profits—excluding passive category income—of a U.S. person that are attributable to one or more "qualified business units" (as defined in Code Sec. 989(a)) in one or more foreign countries. The IRS has published proposed regulations addressing the TCJA changes to the FTC limitations. *See* 83 FR 63,200–66 (Dec. 7, 2018).

6 *See* Section III.D.5 below, regarding control over tax disputes.

7 *See* Reg. §1.1441-1(e)(4) (IRS Form W-8, *Certificate of Foreign Status*); Reg. §1.1445-2(b)(2)(iv) (FIRPTA certificates); Reg. §1.1446-1(c) (required IRS Form W-8 for foreign partners in a partnership); Reg. §31.3406(h)-3 (IRS Form W-9, *Request for Taxpayer Identification Number and Certification*).

Interestingly, some state-law issues can arise depending on the structure of the deal. For example, certain dispositions by partnerships can implicate bulk sale rules.

8 Though not typical, disclosures in the agreement might also allow Seller an exception to an indemnity claim. There are also relevant considerations for negotiating disclosure schedules for deals that have representation and warranty insurance.

9 Often an acquisition agreement will have a "bring-down" of representations and warranties that divide certain categories of representations between fundamental and non-fundamental representations. Fundamental representations (generally encompassing the corporate organization of the assets, the capital structure and the authority of Seller to enter into the deal) will often have to be "brought-down flat," meaning that each of the representations will have to be true and correct in all respects, leaving open the possibility of Buyer not closing on the deal if there is even an immaterial inaccuracy at the Closing Date. Non-fundamental representations will often only be breached if it is expected to cause a "Material Adverse Effect" to Buyer—a heavily negotiated definition in all M&A agreements. Tax reps are somewhere in the middle, with most agreements requiring that the tax reps be true and correct in all "material" respects. Another wrinkle is whether this "bring-down" includes a "materiality scrape," which would read out any materiality qualifier in a representation for purposes of determining whether the representation is true or correct but then would evaluate whether that breach was "material" for purposes of the "bring-down."

10 *See* Part III.E below, regarding indemnification.

11 Bracketed words and phrases in sample provisions here reflect Seller's aspirational language.

12 Disclosures would be expected for this kind of representation in a transaction such as our Base Case.

13 If Seller is already providing a withholding certificate at closing pursuant Reg. §1.1445-2(c)(3), it is possible Seller may object to this representation on the grounds that it is duplicative.

14 *See* Code Sec. 355(e), generally causing a distributing corporation to recognize gain with respect to a Code Sec. 355 transaction in the event an acquisition of 50% or more of the distributing or controlled corporation is part of a "plan" together with the Code Sec. 355 transaction, which may be presumed to exist under Code Sec. 355(e)(2)(B) if the acquisition occurs within two years of the Code Sec. 355 transaction.

15 This representation might be particularly relevant with respect to Code Sec. 965 inclusions paid in eight year installments. *See* Part III.C.5.b below.

16 If Seller is a U.S. parented group, all of the foreign Target Entities will be CFCs, but if Seller is a foreign parented group, it may not be as clear, even with the expanded attribution rules following the repeal of Code Sec. 958(b)(4). Although our Base Case assumes the Seller is a U.S. domestic corporation, this is a standard representation in all deals, especially given this expansion.

17 It would be unusual for a foreign Target Entity of a U.S. parented group to have embedded in it a Code Sec. 7874 taint in it from a prior transaction. However, depending on the history and background of that foreign Target Entity before the U.S. parented group acquired it, there may be an issue for which Buyer would want a representation.

18 Note that Proposed Reg. §1.956-1 reduces the amount includible under Code Sec. 956 by the amount that would qualify for the participation exemption under Code Sec. 245A with respect to U.S. corporate shareholders.

19 This article does not cover the GILTI regime in detail. *See* Nicholas J. DeNovio et al., *Multinational Financial Groups After the U.S. Tax Reform: Selected Inbound and Outbound Issues*, INT'L TAX J., Mar. 2018, at 11; Ethan S. Kroll et al., *GILTI, FDII, and the Future of International IP Planning*, INT'L TAX J., May 2018, at 37.

20 Or a transfer of a U.S. Target Entity for which a Code Sec. 338(h)(10) is made and the U.S. Target Entity has a CFC for which a Code Sec. 338 election is made. *See* Sam K. Kaywood, Jr. and Michael Senger, *Taxable Acquisitions of Foreign Corporations in a Brave New World*, INT'L TAX J., Feb. 2019, at 13.

21 Reg. §1.338-9(b)(2) has the effect of treating Seller as owning the transferred CFC stock on the Code Sec. 338 acquisition date and the

target's tax-year closes for Code Sec. 951 purposes under Reg. §1.338-9(d).

[22] Note that Reg. §1.338-2(d) gives Buyer the unrestricted right to make the election. As a general overview, there must be a "qualified stock purchase" under Code Sec. 338(d)(3), generally meaning a purchase of at least 80% of the target stock within a 12-month time period, for the election to be available. The election must be made no later than the 15th day of the ninth month after the acquirer has acquired 80% of the target. Code Sec. 338(g)(1). The election in irrevocable once made. Code Sec. 338(g)(3).

[23] Or a transfer of a U.S. Target Entity for which a Code Sec. 338(h)(10) is not made and the U.S. Target Entity has a CFC for which to Code Sec. 338(g) election could thus be made.

[24] Readers of this journal are familiar with the GILTI "year-end" issue, in which the accumulated earnings & profits ("E&P") before a CFC's year-end from tested income will create a Code Sec. 1248 deemed dividend from the sale of CFC stock for which a Code Sec. 245A participation exemption is allowed. *See* Sam K. Kaywood, Jr. and Michael Senger, *Taxable Acquisitions of Foreign Corporations in a Brave New World*, INT'L TAX J., Feb. 2019, at 13.

[25] These items include tested income (Code Sec. 951A(c)(2)(A)), tested loss (Code Sec. 951A(c)(2)(B)), qualified business asset investment ("QBAI") (Code Sec. 951A(d)(1)) and interest expense (Code Sec. 951A(b)(2)(B)).

[26] *See, e.g.*, Sam K. Kaywood, Jr. and Michael Senger, *Taxable Acquisitions of Foreign Corporations in a Brave New World*, INT'L TAX J., Feb. 2019, at 13.

[27] Code Sec. 338(g)(2); Reg. §1.338-2(d).

[28] Code Sec. 338(a)(1); Reg. §1.338-4(e).

[29] Reg. §1.338-10(a)(1).

[30] Reg. §1.338-1(b).

[31] Code Sec. 338(b).

[32] Reg. §1.338-2(e)(4).

[33] Reg. §1.338-2(e)(4)(v).

[34] For example, Seller might seek to exclude information that relates to its non-transferred Seller Affiliates.

[35] For similar reasons, the information sharing and cooperation covenant is important with respect to a litigation proceeding concerning the tax treatment of the transaction between Buyer and Seller itself.

[36] Such provisions can, however, have a conceivable impact on Seller. For example, if Buyer changes a long-standing tax reporting position of a Target Entity, it could provoke an examination of a Pre-Closing Tax Period.

[37] Some of these considerations may be addressed in other sections of the agreement, even as they relate to tax contests.

[38] Note that these audits and proceedings would necessarily take into account the fact that U.S. Target Entity was a member of the Seller consolidated group during the tax years at issue.

[39] Reduced to 2% for banks and registered security dealers. Code Sec. 59A(e)(1)(C), Code Sec. 59A(b)(3)(B).

[40] Code Sec. 59A(c)(4), Code Sec. 59A(e)(1)(C).

[41] Code Sec. 59A(c)(4).

[42] *See supra* Part II.B, note 5.

[43] *See* Part III.D.5 above for general considerations with respect to the control of tax related audits and examinations.

[44] Reg. §1.338-9(b).

[45] Reg. §1.338-10(a)(1).

[46] Reg. §1.338-1(b).

[47] Code Sec. 338(b).

[48] For Seller, the gain from the deemed sale of the CFC's assets may be foreign personal holding company income and thus subject to tax at the U.S. shareholder level under Code Sec. 951(a), which did not change under the TCJA. This gain would increase basis in the CFC under Code Sec. 961. Pre-TCJA, other issues could arise that could impact the FTC consequences to Seller under Code Sec. 1248 and Code Sec. 902. *See, e.g.*, Lowell D. Yoder, *CCA 200103031: Does §338(h)(16) Apply to Deemed-Paid Credits?* 30 TAX MGMT. INT'L. J. 443 (2001) (discussing deemed-paid credits with respect to Code Sec. 338(h)(16)); Lowell D. Yoder, *Selling CFC Stock with a §338 Election: §1248 and Foreign Tax Credit Consequences*, 33 TAX MGMT. INT'L. J. (2004). Beginning in 2011, Code Sec. 901(m) eliminated the possibility of supercharging FTCs on acquisitions that were treated as asset acquisitions for U.S. federal income tax purposes but not foreign tax purposes. *See* Lowell D. Yoder, *Impact of Code Sec. 901(m) on Foreign Acquisitions*, INT'L TAX J., July–Aug. 2011, at 3.

[49] Code Sec. 951(a); Code Sec. 954(c)(1)(B).

[50] Code Sec. 901(m).

[51] Because the Code Sec. 1248 amount included in the Seller's gross income is pro-rated based on the total accumulated E&P for the entire year, distributions in the Straddle Period to Buyer where there is no Code Sec. 338(g) election may adjust the E&P, thus affecting the Seller. Reg. §1.1248-2(e)(2); Reg. §1.1248-3(e)(2).

[52] Code Sec. 951A(d).

[53] *See* Reg. §1.338-10(a)(1); Reg. §1.338-10(b). However, the purging of E&P would eliminate the Target Entity's existing PTI.

[54] The varying installment amounts are set forth in Code Sec. 965(h)(1)(A)–(D), with 25% of the total net Code Sec. 965 liability being paid on the final installment payment.

[55] *See* Reg. §1.1502-6.

[56] *See infra* note 69 regarding the assumption of a Code Sec. 965 liability where the U.S. Target Entity is a member of the Seller's consolidated group.

[57] Reg. §1.965-8(e)(1); Reg. §1.965-7(b)(3)(iii)(B)(5).

[58] Reg. §1.965-8(e)(2) (members of a consolidated group are treated as individual U.S. shareholders of specified foreign corporations for purposes of determining the amount of a member's inclusion under Code Sec. 965).

[59] Reg. §1.965-1(f)(8)(ii); Reg. §1.965-8(e)(4).

[60] Code Sec. 965(b)(5); Reg. §1.965-1(b)(2).

[61] Reg. §1.965-8(e)(1); Reg. §1.965-3.

[62] Code Sec. 965(b)(5). Note that, under Reg. §1.1502-4(c), FTCs across members of a consolidated group are aggregated and a consolidated overall FTC limitation will apply.

[63] Reg. §1.965-7(e)(1). This includes the election to increase basis of deferred income corporation and decrease the basis in an E&P deficit corporation under Reg. §1.965-2(f)(2) and the election to pay the Code Sec. 965 liability in installments under Code Sec. 965(h).

[64] Reg. §1.1502-11, Reg. §1.1502-6.

[65] Reg. §1.965-7(b)(3)(ii)(A).

[66] Reg. §1.965-7(b)(3)(ii)(B).

[67] Reg. §1.965-7(b)(3)(ii)(C).

[68] Reg. §1.965-7(b)(3)(iii)(A)(2).

[69] *See* Reg. §1.965-8(e)(1). If the U.S. Target Entity does amount to "substantially all" of the Seller group's assets, then the Seller group's total Code Sec. 965 liability would be accelerated under Reg. §§1.965-7(b)(3)(ii)(B) and 1.965-7(e)(1). However, where Buyer is an "eligible section 965(h) transferee" under Reg. §1.965-7(b)(3)(iii) and Buyer and Seller execute a "transfer agreement" meeting the conditions of Reg. §1.965-7(b)(3)(iii)(B), the Buyer will then be legally responsible for future Code Sec. 965(h) installment payments under Reg. §1.965-7(b)(3)(iii)(D).

[70] Reg. §1.965-7(b)(3)(ii)(A).

[71] Code Sec. 965(h)(3) provides only that the "unpaid portion" of the Code Sec. 965 liability becomes "due on the date of such event," not specifically that the acceleration causes a tax for the year of the acceleration event.

[72] *See* Reg. §1.1502-6(a).

[73] A deficiency in respect of the net Code Sec. 965 liability will result in a proration of future installment payments to fund the deficiency, except where the deficiency is attributable to negligence, intentional disregard or fraud. Reg. §1.965-7(b)(1)(ii).

[74] Code Sec. 965(l)(2). The Code Sec. 965(c) deductions are those allowed such that the Code Sec. 965 liability computed under pre-TCJA rates would be equal to 8% of the portion of the accumulated post-1986 deferred foreign income not attributable to foreign cash and 15.5% on that portion attributable to the aggregate foreign cash position. Code Sec. 965(c)(1).

[75] Code Sec. 965(l) differs from Code Sec. 965(h)(3) in that the recapture amount under Code Sec. 965(l)(1)(A) is stated as an increase in tax imposed under Code Sec. 965 "for the first taxable year in which such taxpayer becomes an expatriated entity."

[76] Relatedness for this purpose is determined under Code Sec. 267(b) or Code Sec. 707(b)(1). *See* Code Sec. 7874(a)(2)(ii); Reg. §1.7874-12(a)(8)(ii).

[77] Code Sec. 905(c)(1). TCJA §14301(c)(20) amended Code Sec. 905(c)(1) to revoke Treasury's rule making authority to adjust pools of post-1986 accumulated earnings under Code Sec. 902

in the year the foreign tax redetermination occurred. Treasury promulgated Temporary Regulations in 2007 generally providing for forward-looking E&P adjustments in the year of a foreign tax determination *in lieu* of retroactive U.S. tax adjustments. *See* Reg. §1.905-3T. Due to the demise of Code Sec. 902 and the TCJA's conforming amendments to Code Sec. 905, taxpayers may only rely on these regulations for tax years beginning before January 1, 2018.

[78] Code Sec. 905(c)(3). Note that Code Sec. 6511(d)(3) provides for a 10-year statute of limitations period for claiming a refund or credit despite the general three-year limitations period under Code Sec. 6511(a).

[79] *See, e.g.*, Reg. §1.905-3T(d)(3)(iii).

[80] *See* Joseph A. Myszka and Mark T. Roche, *Cross-Border Tax Dispute Considerations for a Post-Tax-Reform World*, TAX NOTES 1889 (June 25, 2018).

[81] It is noteworthy that when U.S. Target Entity leaves the Seller group, it may take with it excess credits. *See* Reg. §1.1502-79 and Code Sec. 383. Any excess credits inherited by Buyer are subject to the new FTC rules under the TCJA. *See supra* Part IV, note 42. Moreover, when a member of a consolidated group leaves the group, group overall foreign losses, separate limitation losses and overall domestic losses are apportioned to the departing member based on the member's share of group assets that generate foreign-source income subject to recapture under Code Sec. 904(f). Reg. §1.1502-9(c)(2).

[82] Meaning that there is also no Code Sec. 338 election with respect to the CFC Target Subsidiaries, since there would be no underlying qualified stock purchase for any of them.

[83] Code Sec. 965(a). Amounts taxed under Code Sec. 951A will also be included in the CFC's pool of PTI under Code Sec. 959 similar to Subpart F inclusions under Code Sec. 951(a). *See* Code Sec. 951A(f)(1); Proposed Reg. §1.951A-6(b).

[84] Code Sec. 965(b)(4)(A); Reg. §1.965-2(d).

[85] *See supra* Part III.E.3, note 39 for rules applicable to certain financial institutions.

[86] Code Sec. 59A(d).

[87] In general, to be eligible for the services cost method under Reg. §1.482-9(b) and thus qualify for the exception to the BEP definition, the service for which payment is made must constitute a "covered service" under Reg. §1.482-9(b)(3) and must not constitute an "excluded activity" under Reg. §1.482-9(b)(4) (generally encompassing manufacturing, production, extraction, construction, distribution, research and development, engineering, financial transactions, and insurance or reinsurance). Adequate books and records must also be maintained under Proposed Reg. §1.59A-3(b)(3)(i)(C) for purposes of qualifying for the exception under BEAT.

[88] In deal jargon, a tax benefit offset might be framed as viewing the Buyer tax profile with the deductible Loss in its return and without (the "within and without" approach).

[89] Code Sec. 163(j)(1)(B). For a brief discussion and overview of Code Sec. 163(j), *see, e.g.*, Moshe Spinowitz and Robert Stevenson, *To Check or Not to Check? The TCJA's Impact on Entity Classification Decisions*, INT'L TAX J., Apr. 2019, at 17; Diana S. Doyle, Christopher J. Ohlgart and Samuel R. Weiner, *Part 1: The Graphic Guide to Section 163(j)*, 71 TAX. EXEC. 2 (2019).

[90] Former Code Sec. 163(j)(2)(B)(ii), (iii).

[91] *Id.*

[92] Code Sec. 163(j)(1)(B).

[93] Code Sec. 163(j)(2).

[94] *See* Proposed Reg. §§1.163(j)-1 through -10.

[95] Proposed Reg. §1.163(j)-11(b)(1).

[96] Proposed Reg. §1.163(j)-11(b)(6).

[97] Proposed Reg. §1.163(j)-4(d)(2).

[98] Proposed Reg. §1.163(j)-5(b)(3)(iii).

[99] Proposed Reg. §1.163(j)-5(d).

[100] There may be a related but distinct issue with respect to non-party summonses or subpoenas issued to the Target Entity in a third-party's tax dispute. First, does Buyer or Seller control the responses, and what are the rights permitting notice, coordination or consent for whomever does not have control? It is not clear that responses to non-party discovery requests would fall into the contractual provisions about control over tax disputes or the contract's general contest provisions.

[101] The common interest privilege is related to, but distinct from, the "co-client" privilege, which applies when one attorney represents multiple clients, and the "joint defense privilege," which applies when defendants in litigation enter into written joint defense agreements. *See* Gregory B. Mauldin, *Invoking the Common Interest Privilege in Collaborative Business Ventures*, THE FEDERAL LAWYER 54 (Nov./Dec. 2009). It has been applied in the context of tax proceedings. *See id.,* at 54–58 (collecting and surveying cases).

[102] *See id.*

[103] *See id.*

[104] Foreign Account Tax Compliance Act, P.L. 111-147 (Mar. 18, 2010).

[105] *See* Large Business and International Compliance Campaigns, *www.irs.gov/businesses/large-business-and-international-compliance-campaigns* (last accessed Apr. 17, 2019).

[106] *See* Thomas Neubig, *Global Tax Administration Initiatives Addressing Tax Evasion and Avoidance*, 91 TAX NOTES INT'L 1137 (Sept. 10, 2018); Imke Gerdes, *Understanding and Preparing for Multilateral Tax Audits*, 91 TAX NOTES INT'L 1111 (Sept. 10, 2018); *Conversations: Jeffrey Owens and Robert Stack*, 87 TAX NOTES INT'L 715 (Aug. 14, 2017).

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