Post-Acquisition Integration Considerations for M&A Transactions

2023 U.S. Cross-Border Tax Conference

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Solve for Complexity

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Presenters

Orla Gavin

Partner, International Tax
KPMG in Ireland

Stephen Massed

Principal, KPMG US
WNT, M&A Tax

Matthew White

Principal, KPMG US
WNT, M&A Tax

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Agenda

01 Pillar Two and CAMT implications for intragroup transfers

02 US MNE acquires foreign MNE

03 Foreign MNE acquires US MNE

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01

Pillar Two and CAMT implications for intragroup transfers

GloBE rules related to asset sales post-effective date

Computing seller's gain or loss on disposition

- In general, seller must include its gain or loss on a disposition of its assets in computing net GloBE income or loss
  - A multinational enterprise ("**MNE**") group that otherwise accounts for an intercompany transaction at cost (*e.g.*, under GAAP) must apply arm's length principles (*i.e.*, must account for transaction at FMV)

Computing acquirer's asset basis after acquisition:

- In general, acquirer must use adjusted carrying value of acquired assets as determined under the financial accounting standards of the ultimate parent entity ("**UPE**")
  - Recent administrative guidance does not address buyer consequences where transaction is accounted for at cost, but indicates that "further work will be undertaken by the Inclusive Framework to address potential double taxation issues without imposing undue compliance burdens" (*e.g.*, permitting buyer to take into account GloBE deferred tax asset ("**DTA**") or basis)

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Transition rule (1)

The transition rule is intended to prevent taxpayers from using intragroup transfers to achieve a basis step-up that would reduce GloBE income (*e.g.*, via depreciation or amortization) without the corresponding gain being subject to GloBE

Model GloBE Rules

- Applies to certain transfers of assets after November 30, 2021, and before the transition year
- The "transition year" is generally the first year the MNE group is subject to GloBE for the jurisdiction (transitional safe harbor can delay transition year)
- Doesn't apply to transfers of inventory
- When the transition rule applies, the acquired asset must be initially recorded at its carrying value (*i.e.*, carryover basis) for GloBE purposes to limit a basis step-up

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Transition rule (2)

Administrative guidance modified the transition rule in two main respects

1. A "transfer of assets" is interpreted broadly to include cross-border and domestic transactions that are treated like a sale of assets from an accounting perspective
2. Relief provided where the transfer is subject to tax:
   - If the disposing entity pays tax with respect to the transfer, or covered taxes attributable to the transfer would be allocated to the disposing entity (*e.g.*, GILTI), or any DTA would have been taken into account under GloBE but was reversed or was not created by the disposing entity ("**Other Tax Effects**"), the acquiring entity may take into account a DTA for GloBE purposes
     - The DTA is generally determined based on the lesser of (1) the tax imposed by reason of the transaction and Other Tax Effects or (2) 15%
   - Alternatively, if the acquiring entity records the asset at fair value in its financial accounts (*e.g.*, under IFRS), it may instead use the carrying value of that asset reflected in its financial accounts for GloBE purposes, as long as the disposing entity paid tax on the transaction at a rate of at least 15%

The administrative guidance also imposes certain substantiation obligations on MNE Groups

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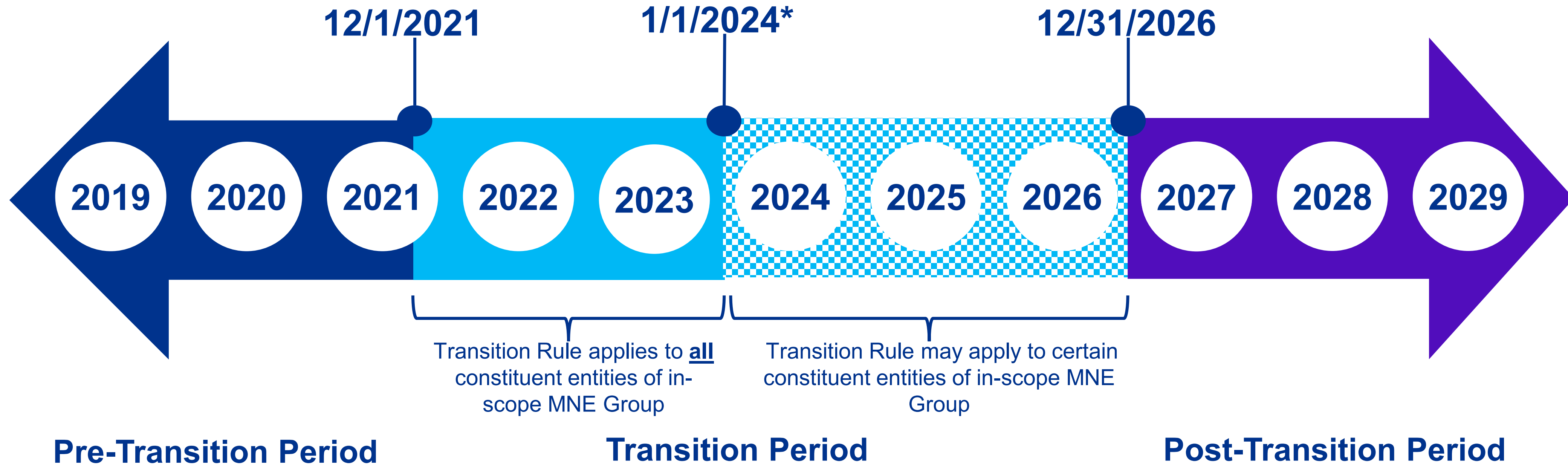
GloBE effective date timeline



- Timeline/dates depicted for calendar year taxpayers

*South Korea's National Assembly passed a tax bill including the Pillar Two framework on December 23, 2022. This provided that the Pillar Two provisions would take effect for fiscal years starting on or after January 1, 2024, including both the IIR and the UTPR. Japan enacted Pillar Two legislation on March 28, 2023, implementing an IIR that would take effect for fiscal years beginning on or after April 1, 2024.

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GloBE transition rule – scope of “transition year”

The transition rule applies to intercompany transfers of assets after November 30, 2021, and before the “transition year”

- Whose transition year matters?
  - While the administrative guidance is unclear in this regard, the better interpretation appears to be that it is the transition year of the *disposing entity* (rather than the acquiring entity) that determines the “transition period” with respect to an intercompany transfer of assets
- In general, when is the disposing entity in its transition year?
  - A constituent entity will have its transition year (and thus out of the transition period) the first year it “comes within the scope” of the GloBE rules, *i.e.*, when it is subject to an income inclusion rule (“**IIR**”), undertaxed profits rule (“**UTPR**”), or a qualified domestic minimum top-up tax (“**QDMTT**”)
  - A US constituent entity in a US-parented group is expected to have its transition year as soon as any country in the group adopts a UTPR (*e.g.*, potentially as soon as 2024, if a Korean entity in the group)
- How does the Transitional Country-by-Country (“**CbC**”) Reporting Safe Harbor impact the transition year?
  - A constituent entity that qualifies for the Transitional CbC Reporting Safe Harbor, and avails itself of the safe harbor, is not treated as being within scope of the GloBE rules, and thus the transition period will continue until the entity no longer satisfies or avails itself of the safe harbor

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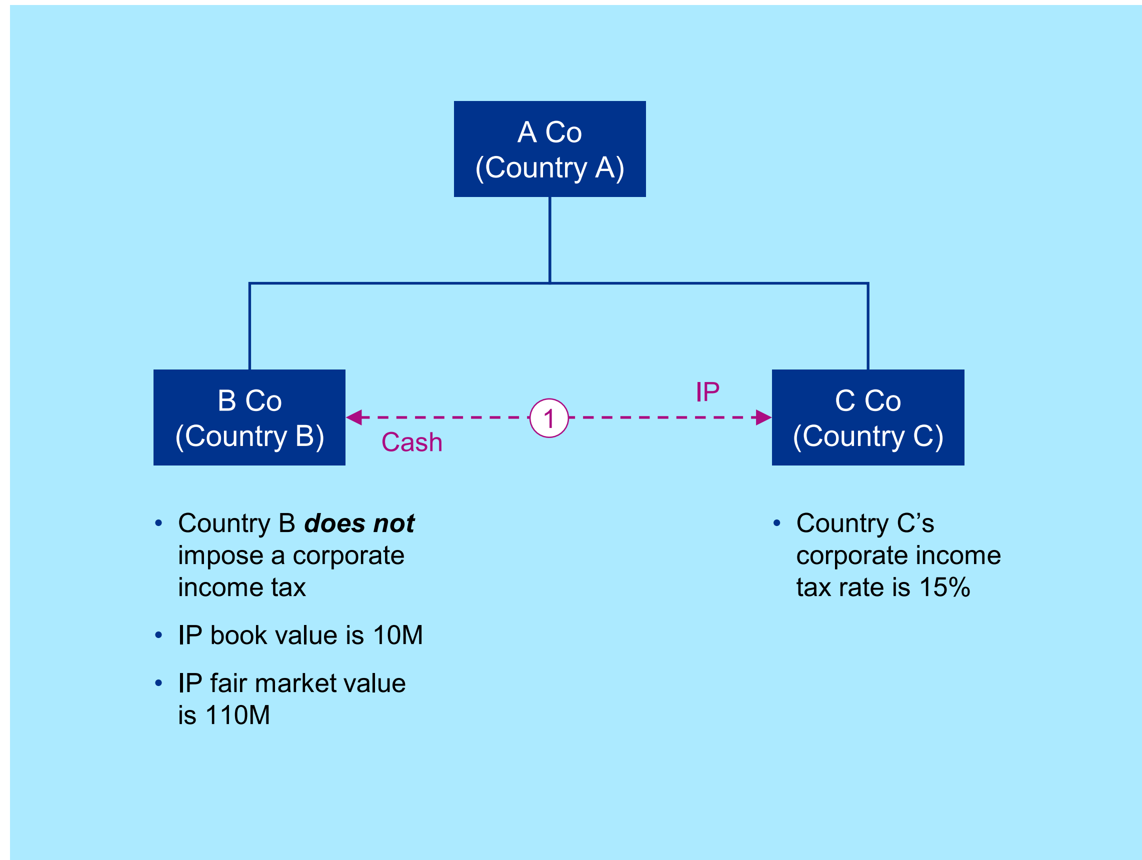
Transition rule: Base case



Facts

- On December 5, 2021, B Co sold IP to C Co for 110M
- The IP was recorded at a carrying value of 10M on B Co's balance sheet
- Had the GloBE Model Rules been in effect immediately before the transfer, B Co and C Co would have been constituent entities of an MNE group
- There are no DTAs with respect to the IP recorded in B Co's or the MNE group's financial accounts

GloBE considerations

- The transition rule applies and C Co will determine its GloBE liability without the benefit of additional amortization deductions or a DTA that otherwise would have resulted from the sale of the IP

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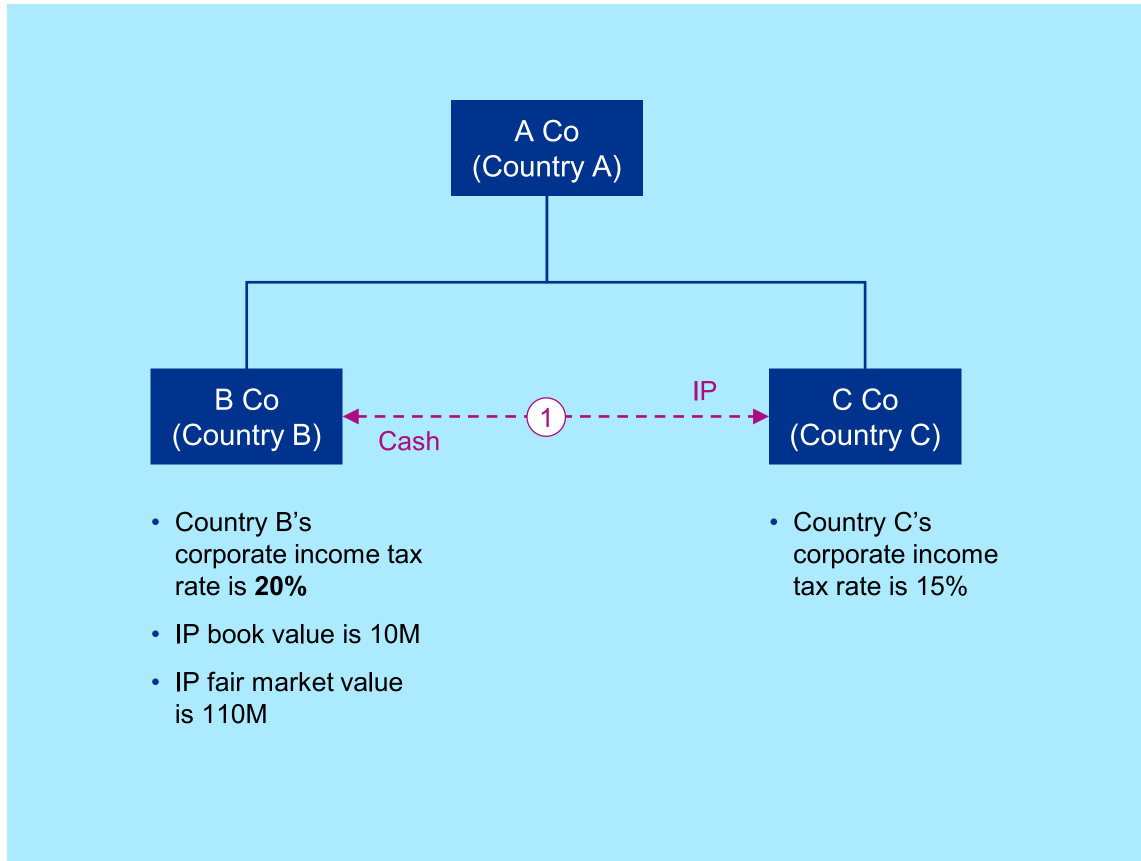
Transition rule: Transactions accounted at cost



Example 9.1.3-2 of the Administrative Guidance on the GloBE Model Rules

Change in facts from base case

- B Co paid 20M of tax on 100M of taxable income for its 2021 taxable year
- Under the applicable accounting standard, C Co's carrying value of the IP is 10M, but C Co records a 20M DTA with respect to the IP

GloBE considerations

- The GloBE carrying value of the IP is 10M
- C Co is allowed a DTA equal to the lesser of the amount of tax paid in respect of the intercompany gain on the asset transfer or 15%
- Accordingly, C Co is entitled to a 15M DTA for GloBE purposes
- The GloBE DTA is adjusted annually along with the DTA that reverses for financial accounting purposes
- The GloBE DTA reversal is included in C Co's Adjusted Covered Taxes, neutralizing the effect of book/tax differences resulting from tax amortization of the IP

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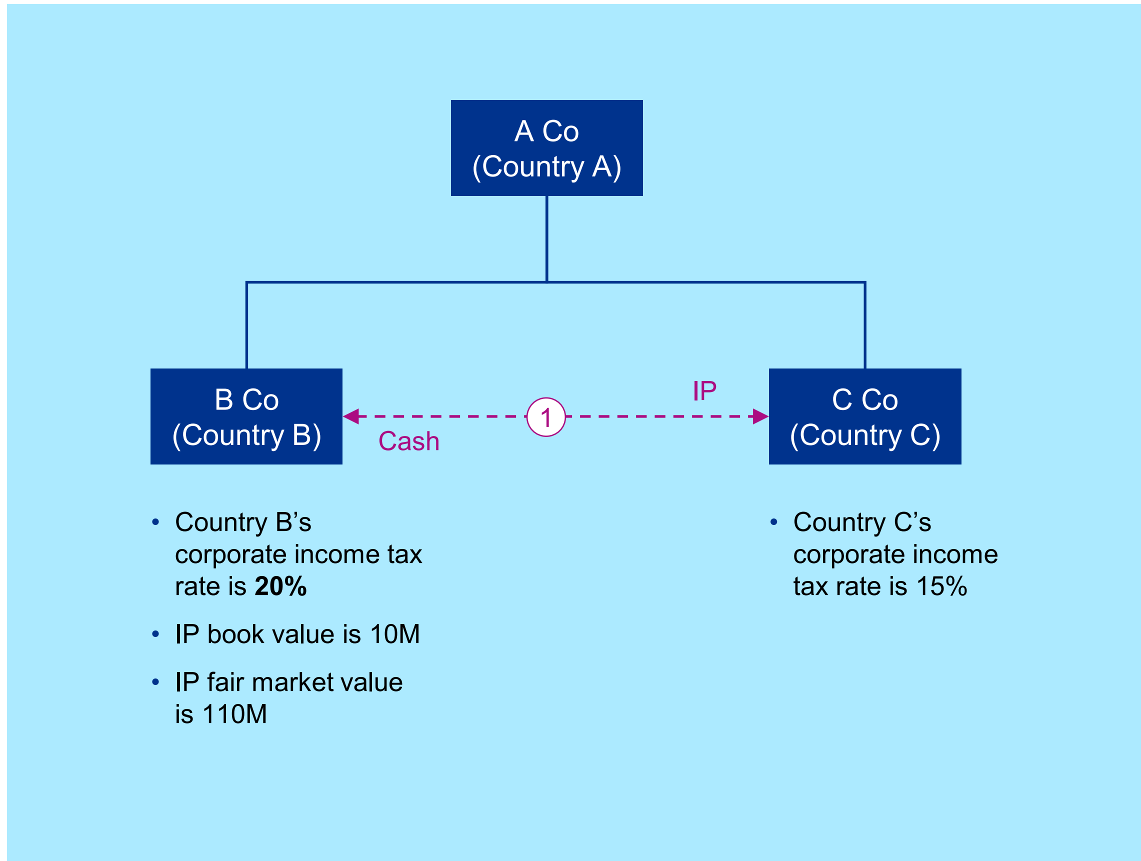
Transition rule: Transactions accounted at value



Example 9.1.3-7 of the Administrative Guidance on the GloBE Model Rules

Change in facts from base case

- Under the applicable accounting standards, C Co's carrying value of the IP is 110M and the tax basis for local tax purposes is equal to the accounting carrying value
- No DTA is accrued

GloBE considerations

- As in the prior example, in general, the GloBE carrying value of the IP would be 10M and a DTA of 15M would be taken into account for GloBE purposes
- The GloBE DTA is adjusted annually along with the amortization of the IP carrying value
- The GloBE DTA reversal is included in C Co's Adjusted Covered Taxes, neutralizing the effect of book/tax differences resulting from tax amortization of the IP
- Alternatively, because the DTA allowed is equal to or greater than 15% of the gain, C Co may use the financial accounting carrying value of the transferred asset in computing its GloBE income or loss

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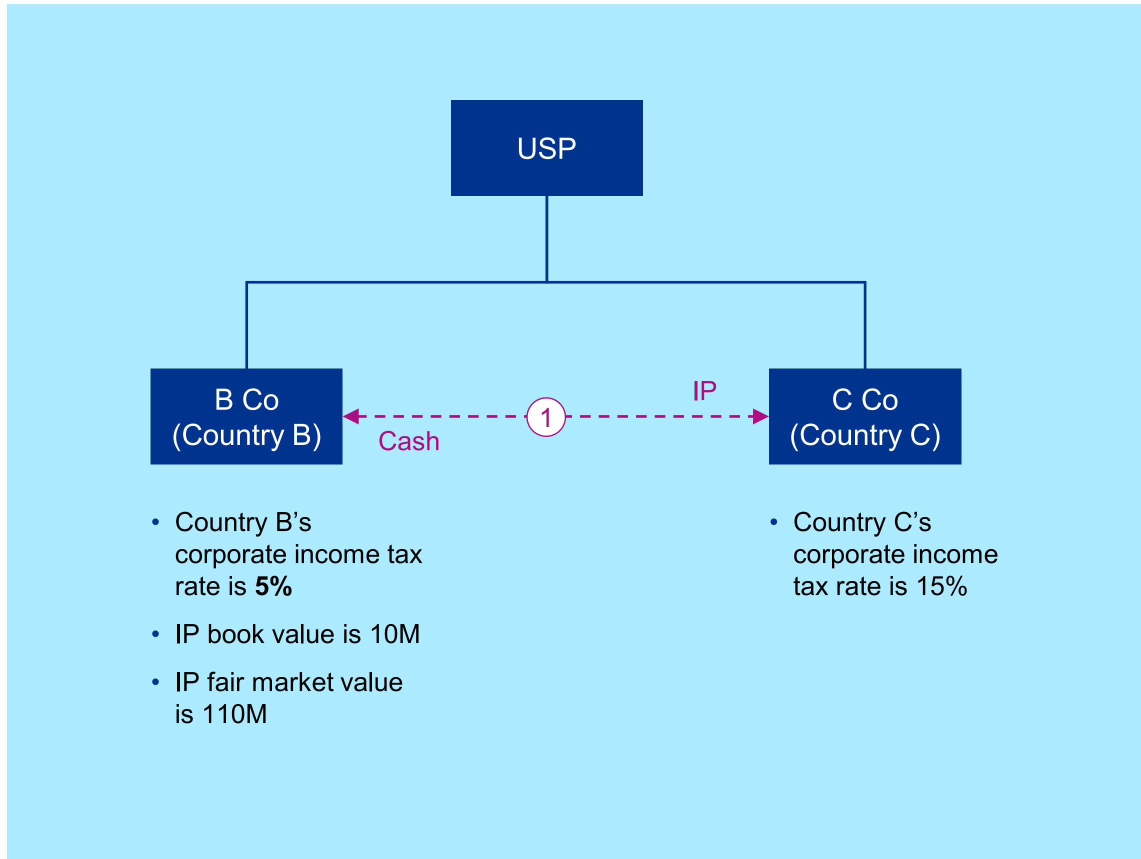
Transition rule: GILTI considerations



Change in facts from base case

- Instead of A Co, USP, a US corporation, is the parent of the group
- As a result of the sale, USP pays GILTI, all of which is allocated to B Co

GloBE considerations

- C Co is allowed a DTA equal to the lesser of the amount of tax paid in respect of the intercompany gain on the asset transfer or 15%
  - C Co's GloBE DTA includes USP's GILTI taxes attributable to the sale
  - The GloBE DTA is adjusted annually along with the DTA that reverses for financial accounting purposes
  - The GloBE DTA reversal is included in C Co's Adjusted Covered Taxes, neutralizing the effect of book/tax differences resulting from tax amortization of the IP

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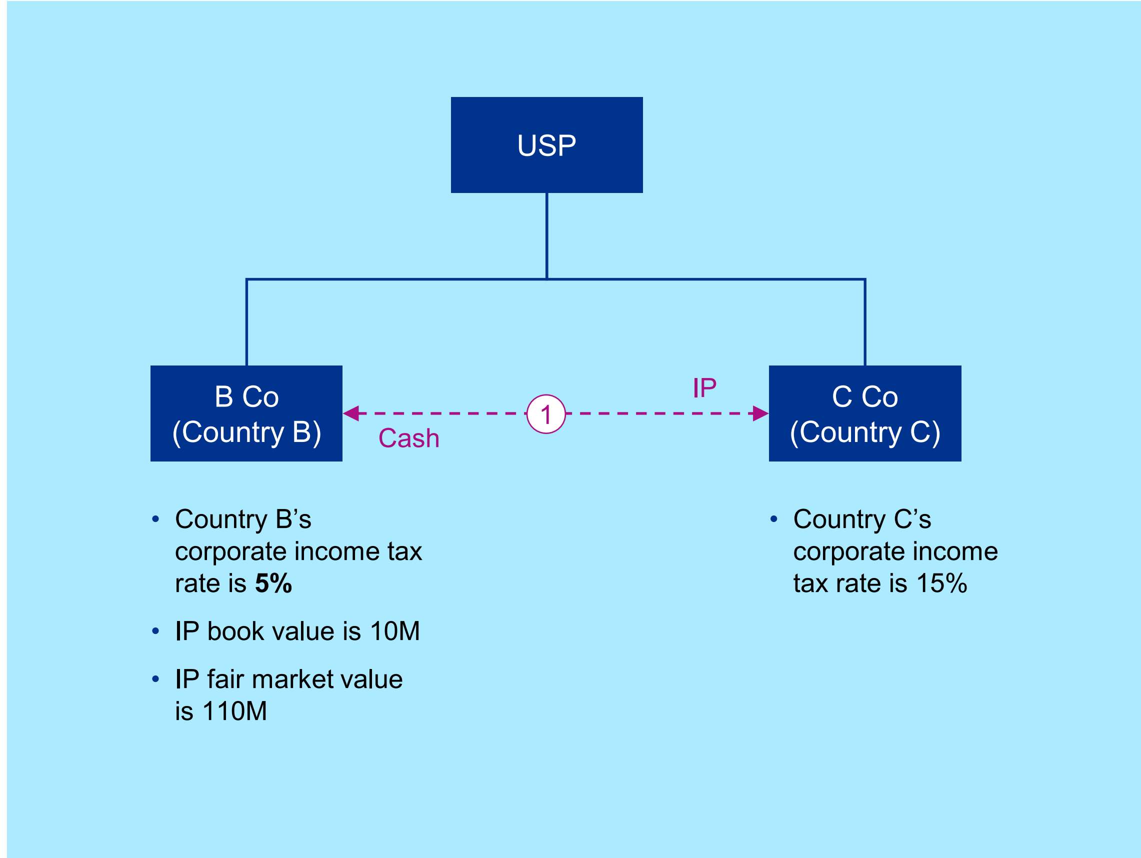
Transition rule: CAMT considerations



CAMT considerations

- Because B Co does not recognize any income under USP's applicable accounting standard (*i.e.*, GAAP), the IP sale likely does not generate any applicable financial statement income ("**AFSI**")
- Because C Co retains the historical carrying value in the IP under GAAP, C Co likely retains the historical carrying value for CAMT purposes as well
  - USP, in determining its pro rata share of C Co AFSI, likely does not take into account the increased amortization with respect to the IP going-forward
- If C Co permits tax amortization of the IP, as C Co amortizes the tax basis in the IP created by reason of the intra-group transfer for Country C tax purposes, but not for book, AFSI is likely increased relative to taxable income
- Further, any resulting CAMT credit cannot be carried backward to offset any regular taxes paid by USP by reason of the IP sale (*i.e.*, the CAMT credit remedies book-tax differences only when book income is accelerated relative to taxable income)

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02

US MNE acquires foreign MNE

2a

US sandwich structures

US sandwich structure considerations (1)

A US sandwich structure occurs when a US-parented group acquires a foreign-parented group with US subsidiaries

US sandwich structure inefficiencies

- Acquirer US corporations cannot consolidate with target US corporations, which can increase the total US taxes paid by the combined group (*e.g.*, losses of one US consolidated group do not offset income of the other US consolidated group)
- GILTI is computed separately for each US consolidated group, and thus, tested income and tested losses of CFCs owned by separate US consolidated groups do not offset
- Distributions by the target US group subject to additional taxation (*e.g.,* US and foreign withholding taxes and subpart F income)

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US sandwich structure considerations (2)

If a US-parented group acquires a foreign-parented group, one of the key structural integration issues from a US tax perspective is the application of section 367(b)

Section 367(b) overview

- Applies when a US corporation acquires the assets of a foreign target corporation in a corporate nonrecognition transaction
- Foreign target shareholder consequences
  - US shareholder or a foreign corporation that has at least one US shareholder includes in income as a deemed dividend the "all E&P amount" attributable to its foreign target stock
    - Potentially eligible for section 245A DRD if requirements satisfied (*e.g.,* section 246(c) holding period), but consider section 1059
    - Shareholder increases its foreign target stock basis for its all E&P amount inclusion
  - Other US persons
    - Must recognize gain (but not loss) in their foreign target stock
    - Election to include the all E&P amount instead of recognizing gain
    - De minimis exception: No income or gain recognized if FMV of foreign target corporation stock exchanged less than $50,000

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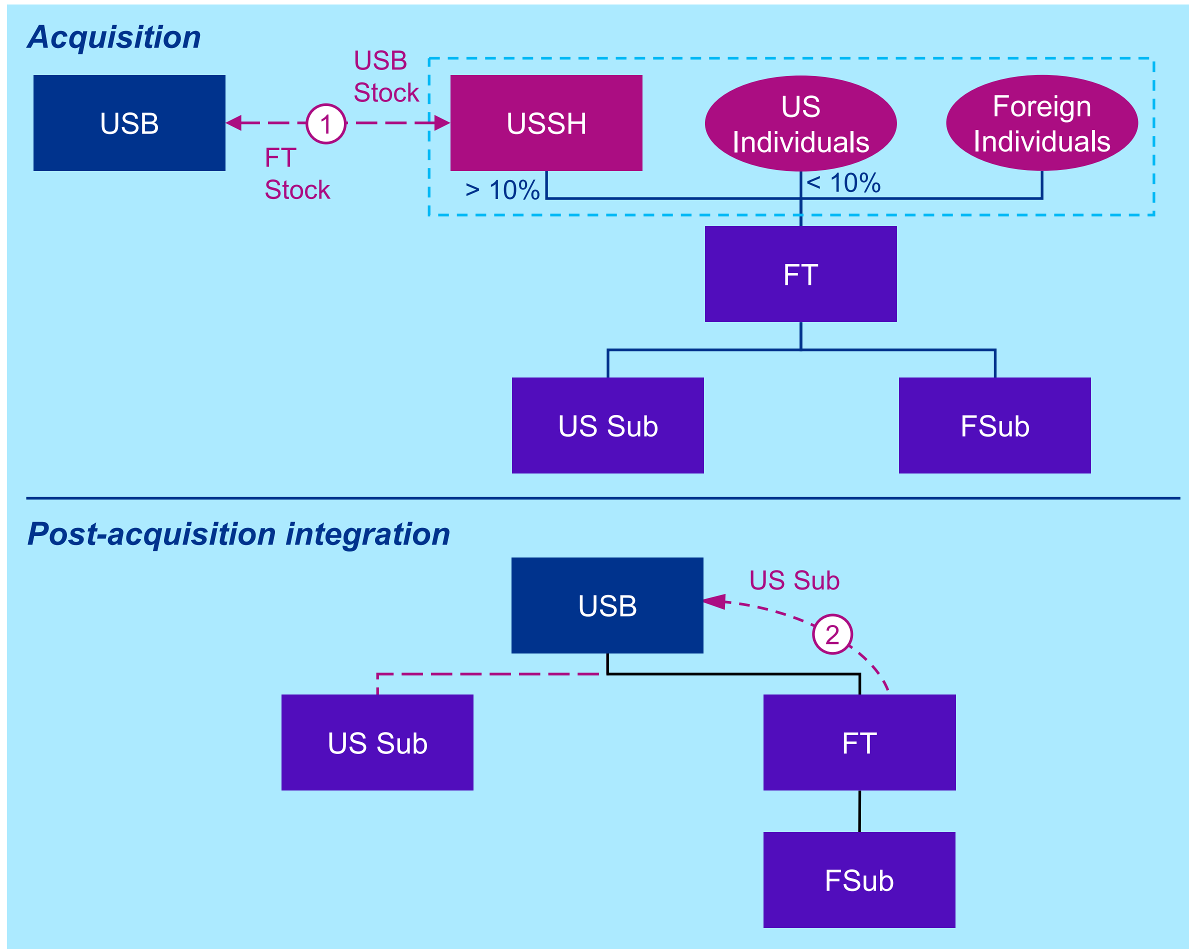
Unwinding the sandwich structure: Example 1



Facts

1. USB acquires FT in a tax-free stock acquisition
2. FT distributes US Sub as a separate, post-closing dividend

US tax considerations

- The FT historical shareholders are not taxed on the acquisition
- USB has a taxable section 301 distribution
  - Dividend income determined by reference to all of FT's E&P
  - If USB continues to hold the FT stock for one year so that it satisfies the section 246(c) holding period requirement, USB benefits from the section 245A DRD
  - The determination of whether USB satisfies the section 1059 holding period requirement is made by reference to the tacked holding period from the historical FT shareholders
- USB includes the section 311(b) gain recognized by FT as subpart F income

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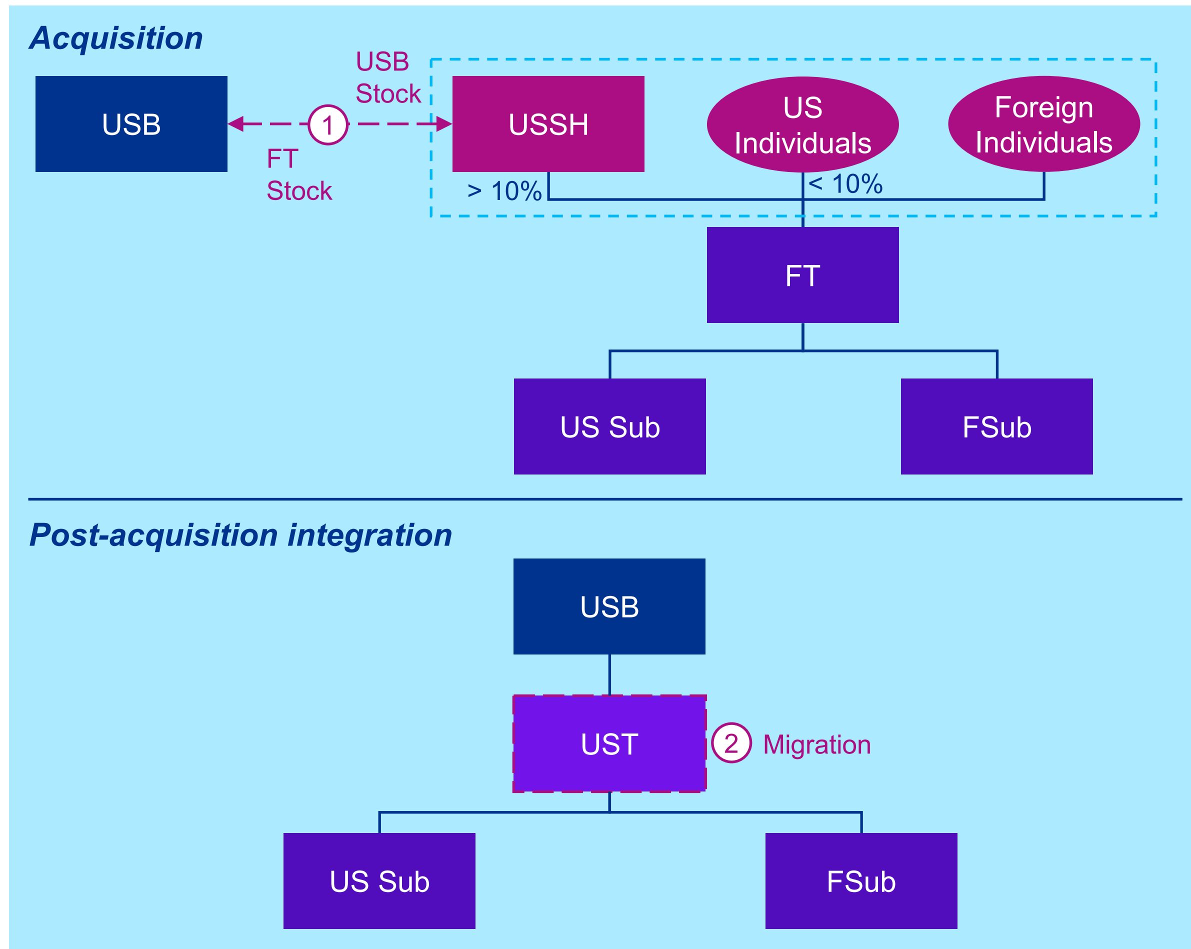
Unwinding the sandwich structure: Example 2 (1)



Facts

1. USB acquires FT in a tax-free stock acquisition
2. In a separate transaction, migrates FT to the United States in an F reorganization

US tax considerations

- FT shareholder consequences are the same as in Example 1
- USB recognizes an all E&P amount dividend, comprised of the E&P attributable to USSH's FT shares and perhaps the US Individuals' FT shares
  - USB's all E&P amount dividend could benefit from the section 245A DRD, but in contrast to Example 1, it appears that USB must wait one year before undertaking the migration to satisfy the section 246(c) holding period requirement
  - Same section 1059 analysis as Example 1
- USB's basis in its FT shares increases by the all E&P amount dividend, which carries over to its UST shares
- FT does not recognize built-in gain with respect to its US Sub stock or FSub stock
- If FT owns assets other than stock, consider transferring the assets to FSub prior to the migration

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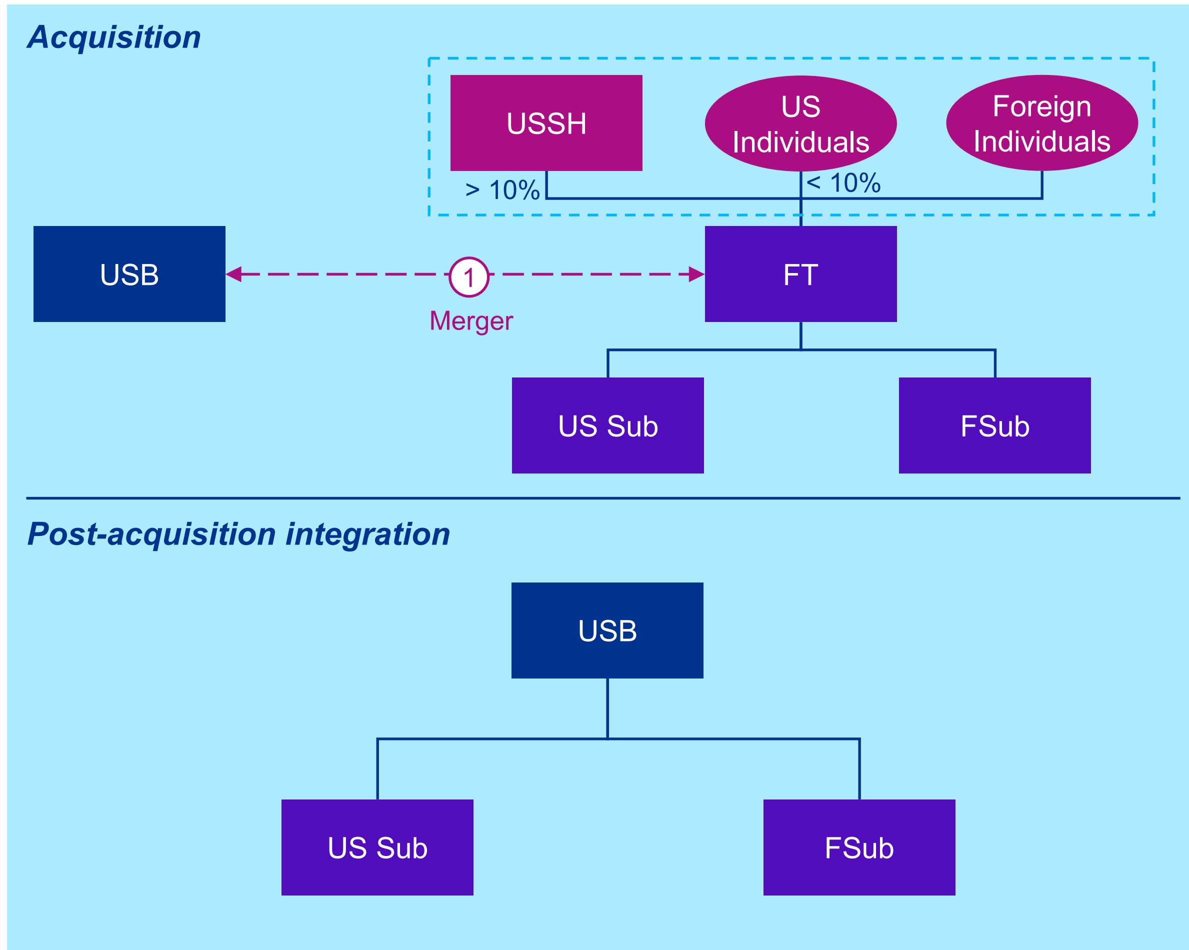
Unwinding the sandwich structure: Example 3



Facts

1. USB acquires the assets of FT in a tax-free merger

US tax considerations

- USSH
  - USSH has an all E&P amount dividend and is allowed a section 245A DRD if it satisfies the section 246(c) holding period requirement
  - USB's basis in its FT shares increases by the all E&P amount dividend, which carries over to its USB shares
- US Individuals
  - Subject to the de minimis exception, the US Individuals recognize gain on their FT shares unless they elect to include their all E&P amount dividends
  - The all E&P amount dividend (if election is made) and FT stock gain increase their FT stock basis, which carries over to its USB shares
- USB does not recognize gain or income and takes a transferred basis in FT's property

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2b

Foreign entity classification

Foreign entity classification considerations

The classification of a foreign entity as a CFC or a disregarded entity can impact its US owners in a number of ways, including:

- Regarded vs. disregarded post-acquisition integration transactions
- QBAI and FTC effects of tested losses
- GILTI high-tax election qualification
- Creditability of withholding taxes on regarded vs. disregarded distributions
- Foreign branch regime vs. GILTI
- BEAT treatment of regarded vs. disregarded outbound payments

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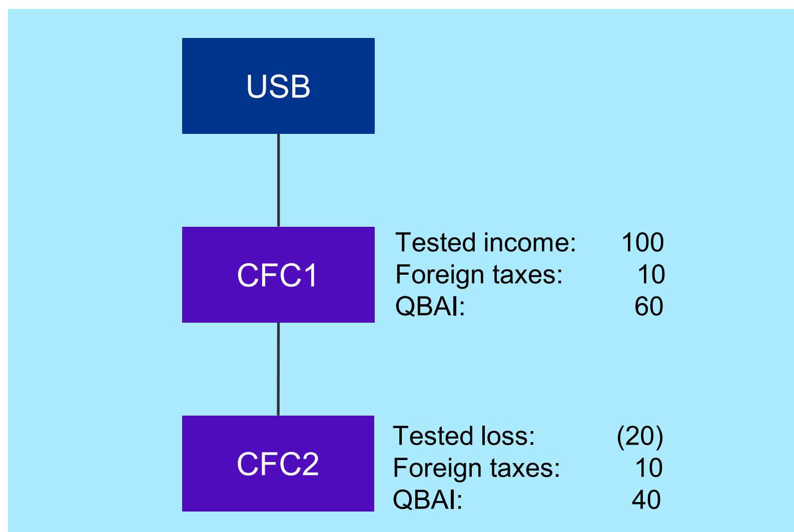
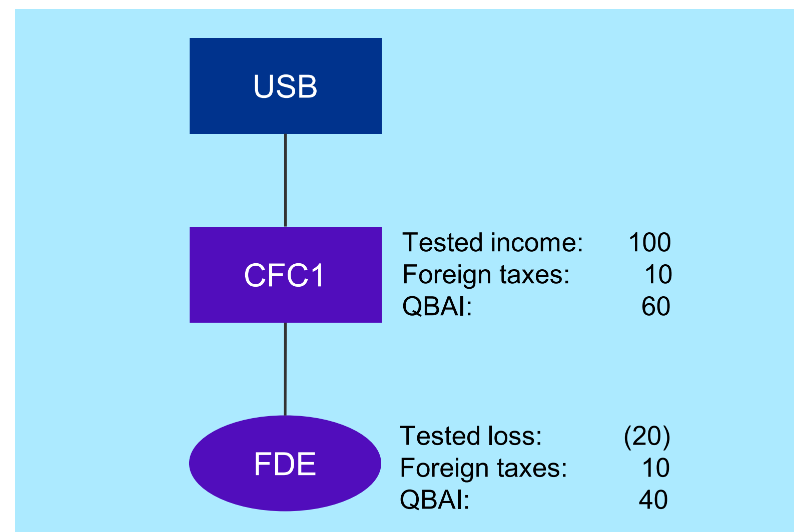
Foreign entity classification: Tested losses



USB tax calculation	
Net tested income (loss)	80
Less: DTIR (60 x 10%)	-6
GILTI	**74**
Add: Section 78 gross-up (10 x 74/100)	7.40
Total inclusion	**81.40**
Less: Section 250 deduction (50%)	-40.70
Net inclusion	**40.70**
Tentative US tax (21%)	8.55
Less: Section 960(d) credits (10 x 74/100 x 80%)	-5.92
Residual US tax (excess credit)	2.63



USB tax calculation	
Net tested income (loss)	80
Less: DTIR (100 x 10%)	-10
GILTI	**70**
Add: Section 78 gross-up (20 x 74/100)	14.80
Total inclusion	**84.80**
Less: Section 250 deduction (50%)	-42.40
Net inclusion	**42.40**
Tentative US tax (21%)	8.90
Less: Section 960(d) credits (20 x 74/100 x 80%)	-11.84
Residual US tax (excess credit)	-2.94

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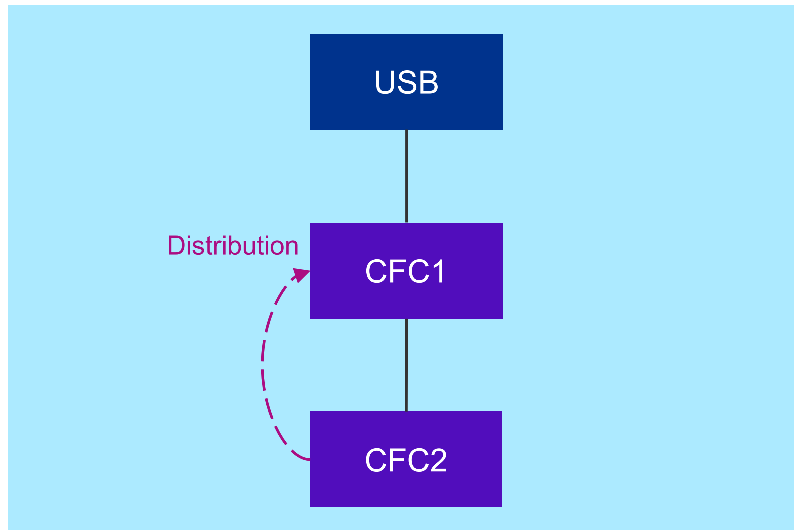
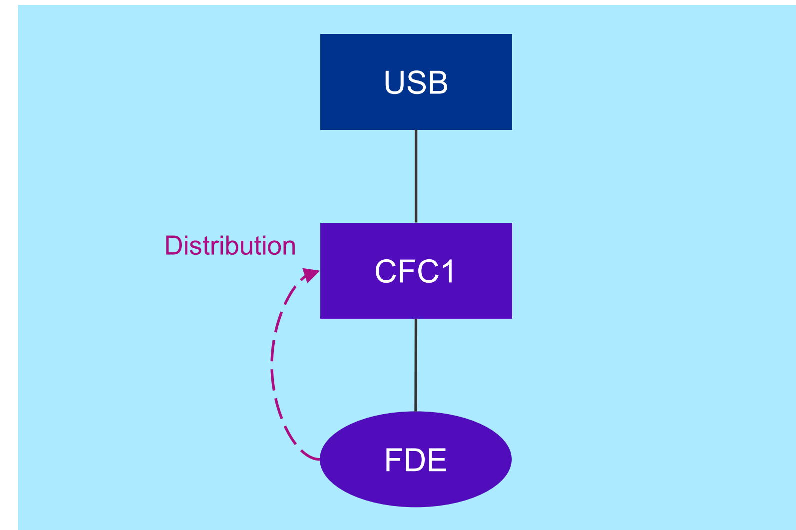
Foreign entity classification: Foreign withholding taxes



FTC considerations

- Tax cannot be deemed paid under section 960(a) or (d)
- If distribution is of untaxed E&P or is a tiered hybrid dividend, no FTCs at all
- If distribution is a PTEP distribution, credits may be available (in the future) under section 960(b) (PTEP received is reduced by withholding taxes)
- Characterization of tax depends on category of PTEP to which tax is allocated (*e.g.*, potential for haircut under section 965(g))
- Section 78 gross-up associated with section 960(b) credits
- Potential CAMT implications



FTC considerations

- Foreign tax characterized based on the characterization of the assets of FDE
- If FDE's assets are all "GILTI assets" all of the foreign withholding tax may be allocable to tested income and may be creditable under section 960(d) (subject to otherwise applicable limitations)
- What if CFC1 has no tested income in the year of distribution?
- Presumably, no CAMT implications because no dividend for US tax purposes
- Passive assets of FDE (e.g., interest-bearing bank account) may cause a loss of all or a portion of withholding tax on account of the withholding taxes being assigned to the passive category

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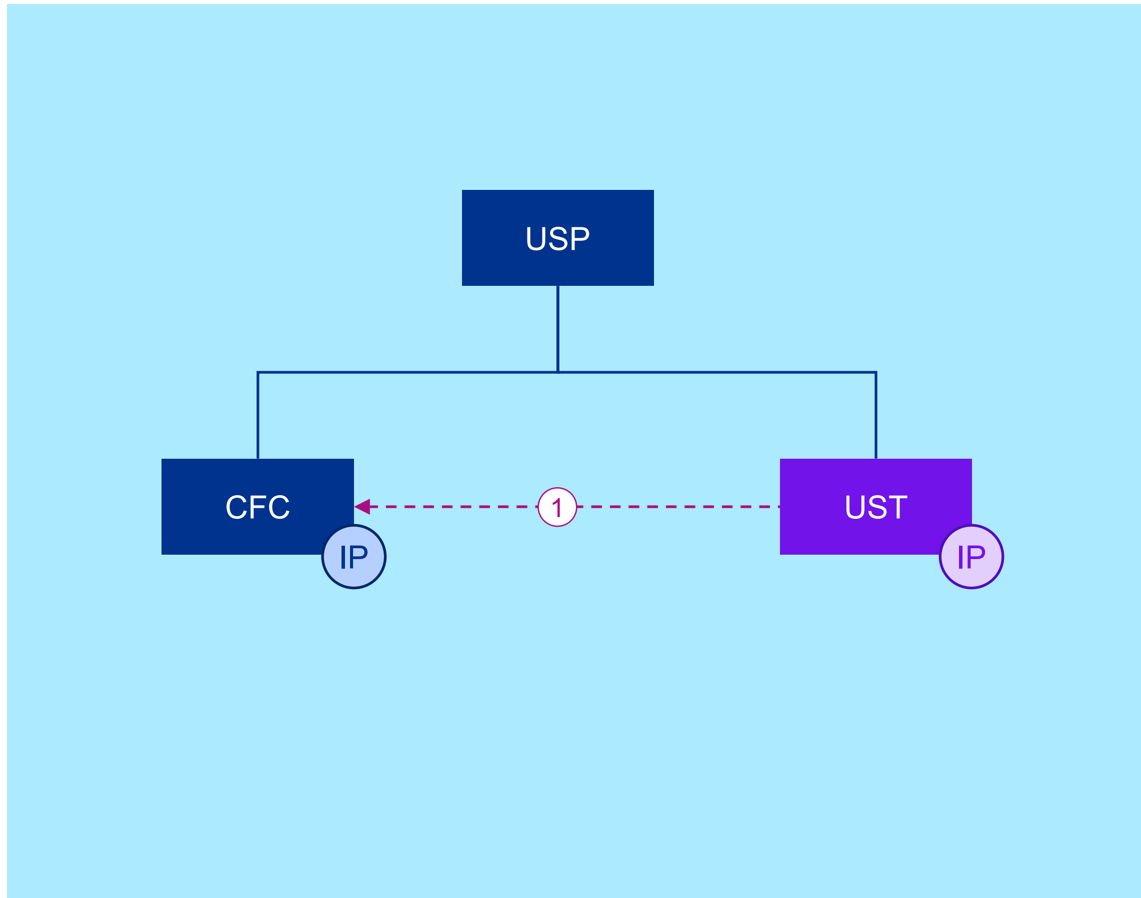
2c

IP considerations

Outbound IP transfers (1)



Facts

1. After USP acquires UST (not shown), UST transfers foreign IP to CFC in a section 351 exchange during the GloBE transition period

US tax considerations

- UST treated as selling the IP to CFC in exchange for section 367(d) annual payments contingent on productivity, use, or disposition of the IP over the useful life of the IP
  - Annual payments are ordinary income and sourced based on the use of the IP
  - UST establishes an annual account receivable equal to the deemed payment, which can be paid without further consequences (unpaid portion after three years is deemed capitalized)
- CFC's deemed annual payments reduce its E&P, subpart F income, and tested income

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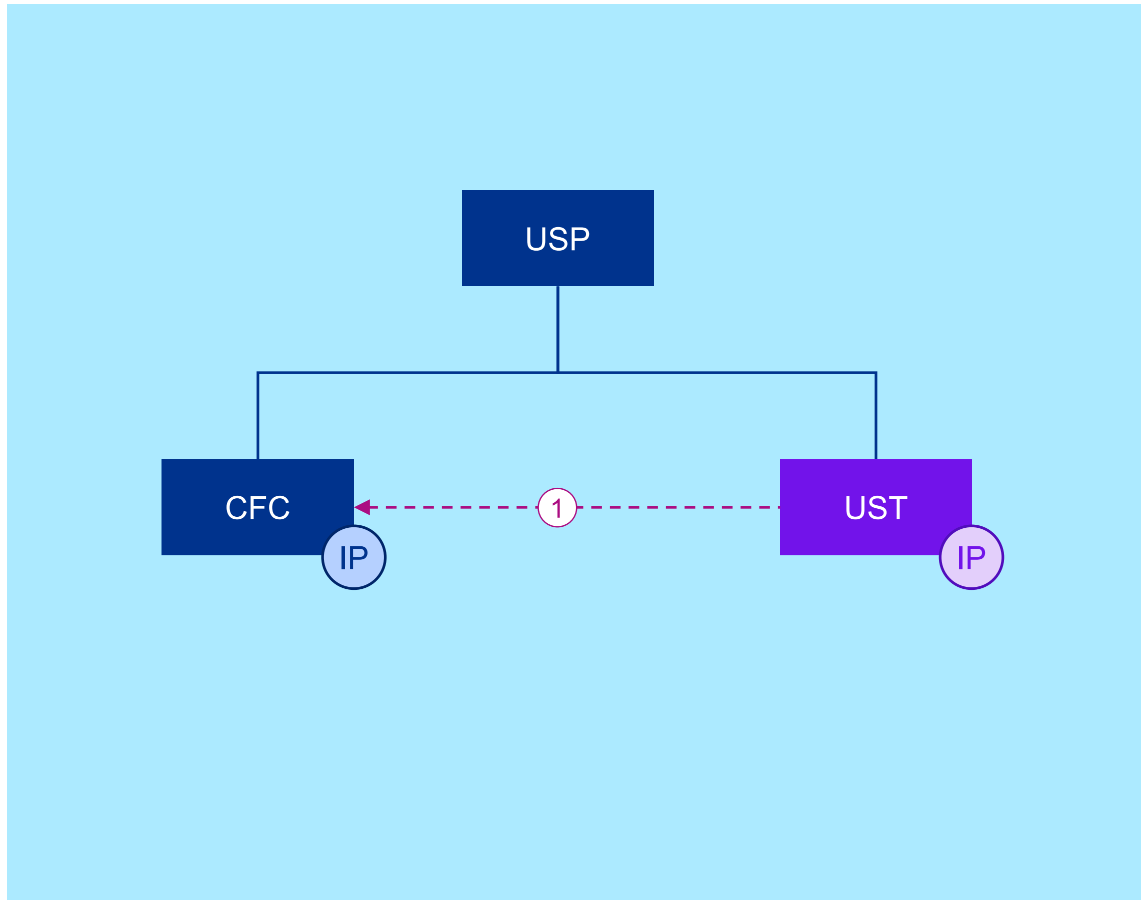
Outbound IP transfers (2)



US tax considerations (Cont.)

- Subsequent disposition of IP
  - Related person: Deemed payment regime continues with related person substituted for CFC
    - No exception if the related person is a US person
  - Unrelated person: Deemed payment regime ceases, and UST recognizes gain (not loss) equal to excess of FMV of IP on the disposition date over its former basis on the outbound transfer date
    - CFC's E&P excludes gain recognized
- Similar rules apply with respect to transfers of the stock in CFC

GloBE considerations?

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Proposed section 367(d) regulations (1)

In general

- Section 367(d) ceases to apply if the transferee foreign corporation subsequently disposes of the IP to a qualified domestic person ("**QDP**") and certain reporting requirements are met
- A QDP is (i) the original US transferor (the "**US Transferor**"), (ii) a successor to the US Transferor that is an individual or a taxable domestic corporation, or (iii) a US individual or taxable domestic corporation that is related to the US Transferor or its successor
  - US partnerships excluded even if all partners are taxable domestic corporations and US individuals
- Proposed regulations apply prospectively to subsequent dispositions of IP occurring on or after the date of publication of final regulations in the Federal Register, and do not include any reliance language
- Operative rules generally depend on whether the subsequent disposition is tax-free, in whole or in part (*i.e.*, the IP is "**transferred basis property**"), or fully taxable
  - In all events, a partial section 367(d) inclusion is recognized for the portion of the current year preceding the subsequent disposition
- Also amend the section 904 disregarded transaction rules as regards IP transfers involving foreign branches

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Proposed section 367(d) regulations (2)

Transferred basis property rules

- The US Transferor recognizes the amount of gain, if any, the transferee foreign corporation would recognize if its basis in the IP were the US Transferor's former basis in the IP
  - The transferee foreign corporation's E&P and gross income is reduced to extent of the gain recognized by the US Transferor
- Subject to other limitations in the Code (*e.g.*, section 362), the QDP's basis in the IP is equal to:
  - The ***lesser*** of the US Transferor's former basis in the IP or the transferee foreign corporation's basis in the IP immediately before the subsequent disposition, ***plus***
  - The ***greater*** of the gain, if any, recognized by the US Transferor or the transferee foreign corporation on the subsequent disposition

Non-transferred basis property rules

- The US Transferor recognizes gain equal to the FMV value of the IP on the date of the subsequent disposition less its former basis in the IP
  - The transferee foreign corporation's E&P and gross income is reduced to extent of the gain recognized by the US Transferor
- The QDP's basis in the IP is equal to FMV at the time of the repatriation

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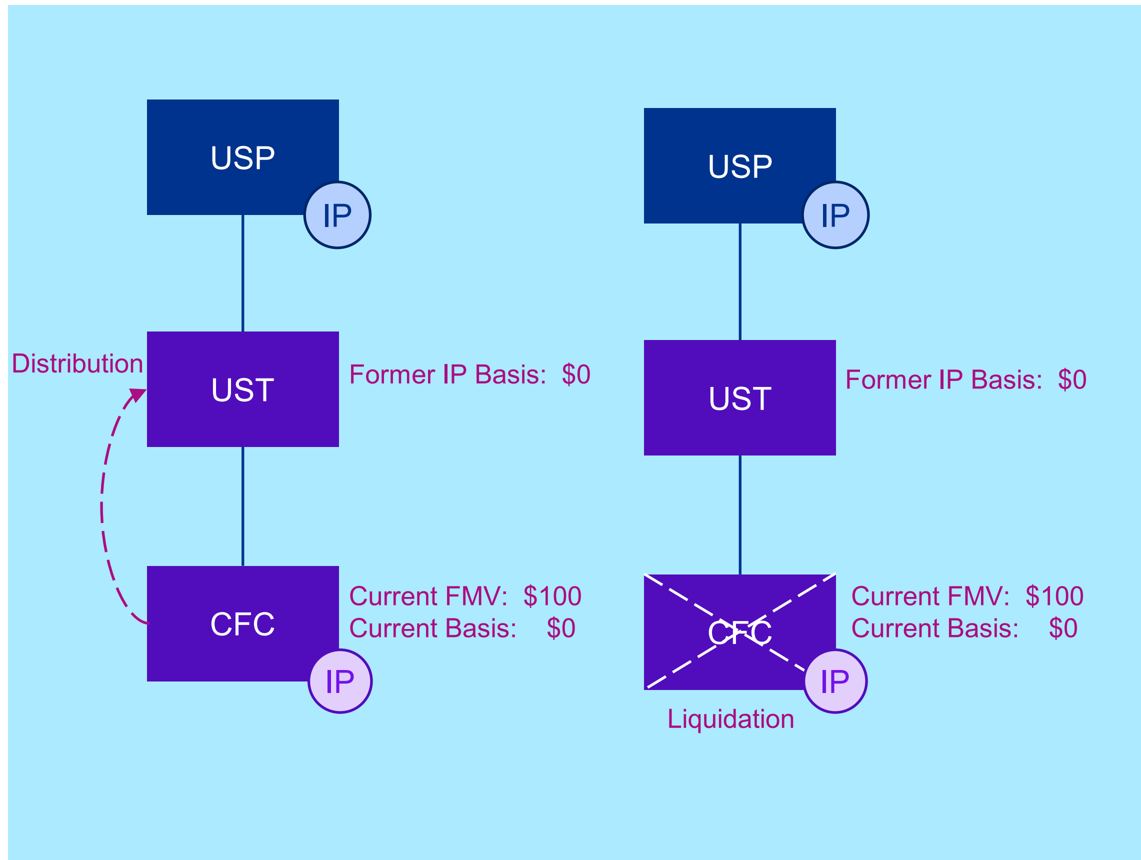
Inbound IP transfers: First-tier CFC



Facts

- Prior to being acquired by USP, UST transferred IP outbound to CFC in a section 351 exchange subject to section 367(d)
- To integrate the CFC IP after the acquisition, CFC will either distribute the IP to UST or liquidate

Section 367(d) Proposed Regulations

- Distribution
  - UST recognizes gain of $100 (current FMV less UST's former basis)
  - UST's basis in the IP is $100
  - CFC's tested income and/or subpart F income and E&P is reduced to reflect UST's gain
- Liquidation
  - UST recognizes $ 0 gain (CFC doesn't recognize any gain)
  - UST's basis in the IP is $0 (UST's former basis and CFC's basis are zero and neither UST nor CFC recognize gain)

What would be the result if a lower-tier CFC was the transferee foreign corporation with respect to the IP?

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03

Foreign MNE acquires US MNE

3a

Foreign sandwich structures

Foreign sandwich structure considerations (1)

A foreign sandwich structure occurs when a foreign-parented group acquires a US-parented group with foreign subsidiaries

Foreign sandwich structure inefficiencies

- CFC earnings subject to GILTI and subpart F income
- CFC earnings may be subject to US withholding tax when repatriated to foreign parent
- CFC operations subject to future changes in US tax law
- Alleviation of double taxation depends on US FTC rules

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Foreign sandwich structure considerations (2)

Ways to potentially address foreign sandwich structures

- Trigger CFC asset-level gain subject to GILTI, which can be offset by excess GILTI FTCs
  - Consider BEAT implications of using GILTI FTCs
  - Consider potential for asset sales to create foreign base company sales income
- Utilize the section 245A DRD
- Live with it; Pillar Two has changed the value proposition of unwinding foreign sandwich structures

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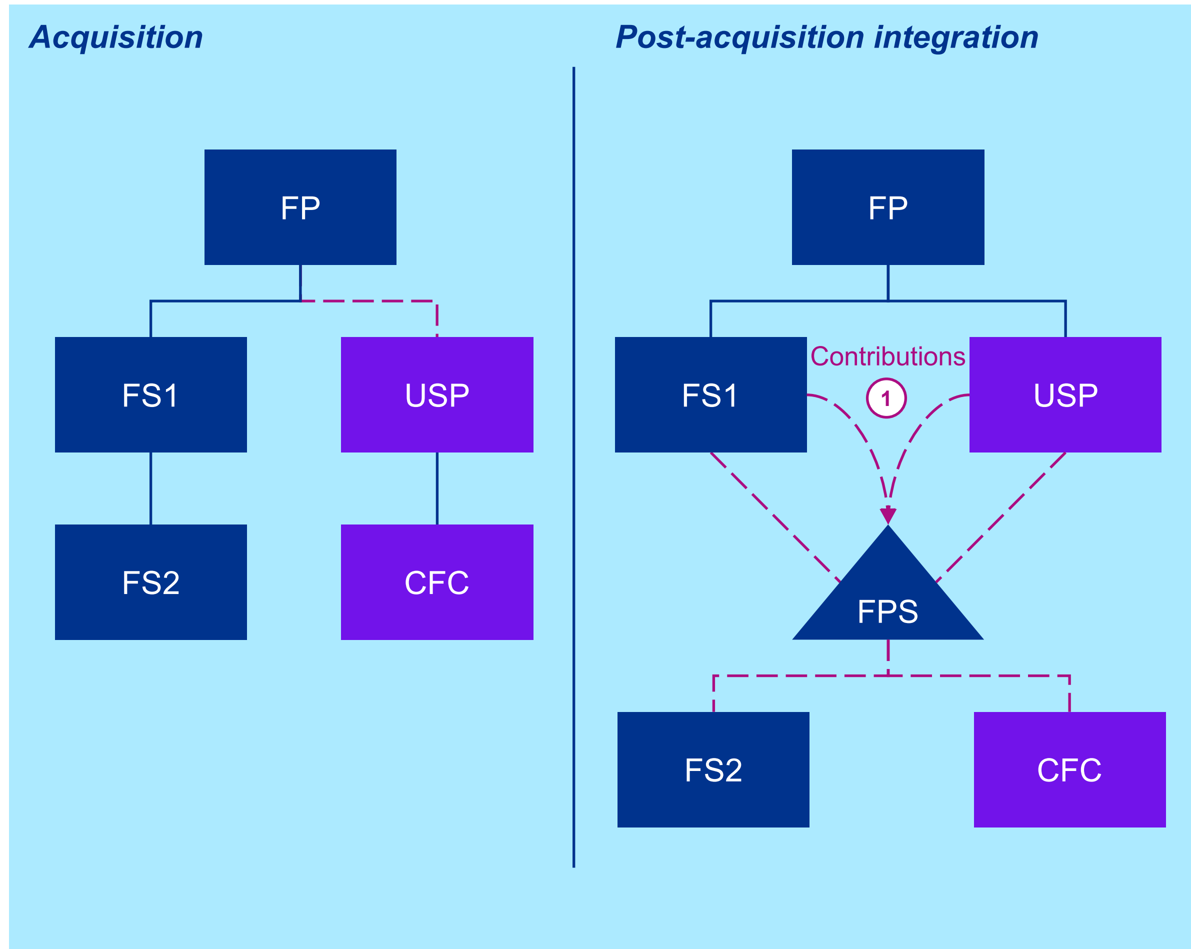
Living with the sandwich structure: Example



Facts

1. USP and FS1 contribute CFC1 stock and FS2 stock, respectively, to FPS, a newly formed foreign partnership

US tax considerations

- The transfer of the CFC stock and the FS2 stock to FPS is intended to be treated as a tax-free section 721 exchange as to USP and FS1, respectively
- CFC and FS2 can be integrated under FPS

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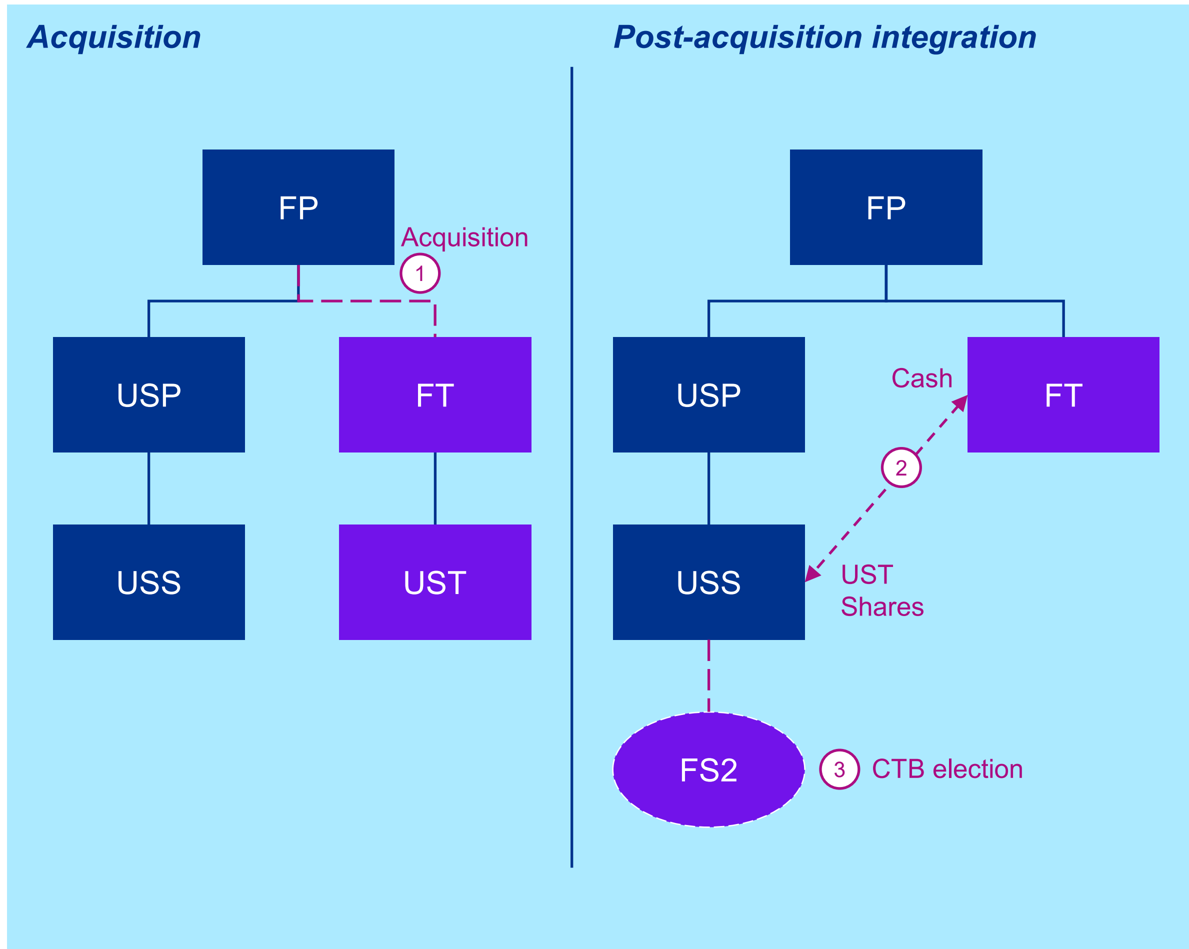
3b

Combining US groups

US target integration: All-boot D reorganization



Facts

1. FP acquires FT, which has a US subsidiary (UST) and makes a Section 338(g) election in connection with the acquisition of FT
2. After the acquisition, FT transfers UST to USS in exchange for cash
3. US Target elects to be a disregarded entity US tax purposes (or converts to an LLC)

US tax considerations

- Steps 2 and 3 are treated as an all-boot D reorganization
  - FT has FMV basis in its UST shares and thus does not recognize dividend income under section 356(a)(2)
  - Transfer of cash from USS to FT is not subject to US withholding tax

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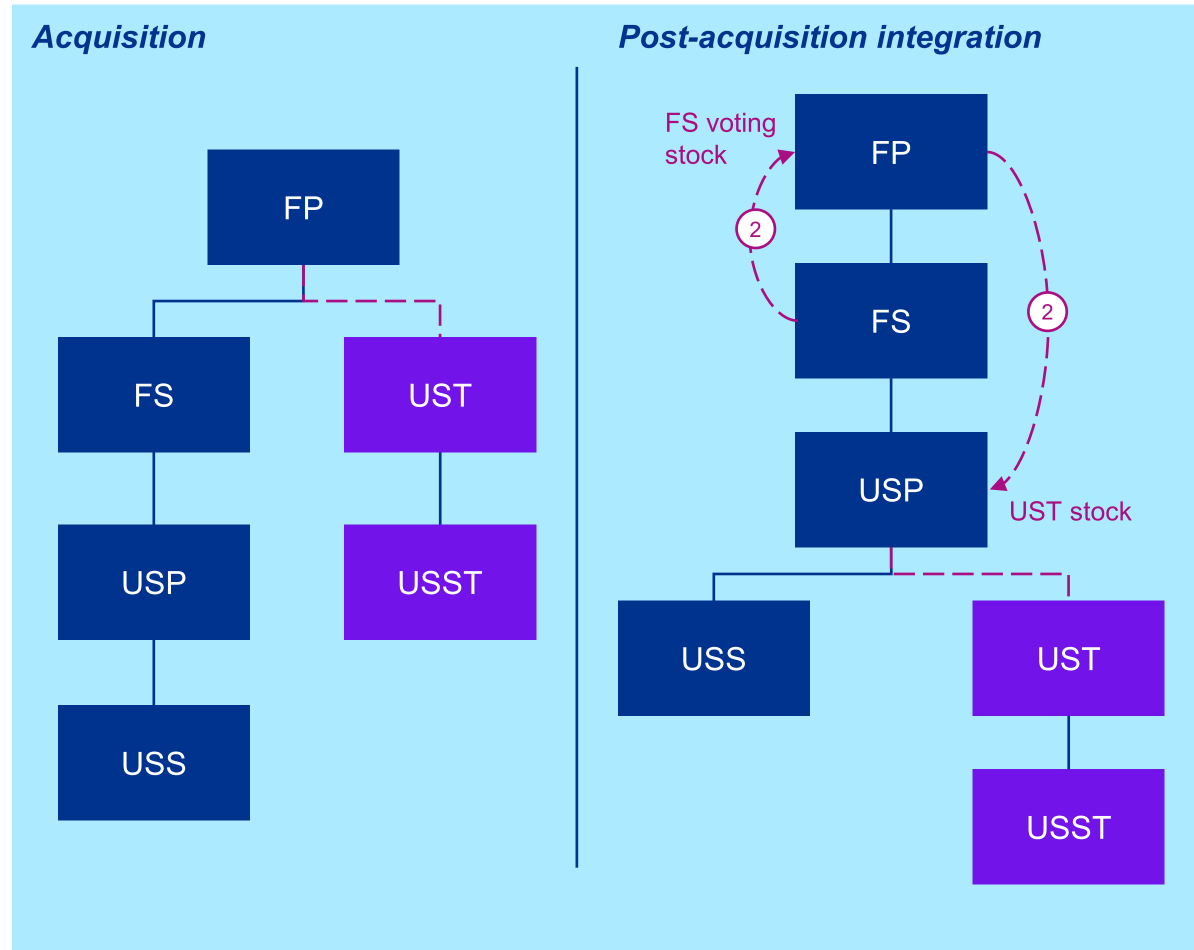
US target integration: SRLY planning



Facts

1. FP acquires UST; the value of UST is greater than the value of USP
2. After the acquisition, FP transfers UST to USP solely in exchange for FS voting stock

US tax considerations

- Transaction is triangular B reorganization that is not intended to be treated as a "reverse acquisition" under the consolidated return regulations
- The E&P of UST are effectively eliminated under the separate return limitation year ("**SRLY**") rules in the consolidated return regulations when distributed from UST to USP and thus are not available to source dividends from USP to FS

Additional considerations

- What would be the result if FS elected to be a disregarded entity before Step 2?
- What would be the result if FS elected to be a disregarded entity before Step 2 and USP was instead transferred to UST?

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Today's presenters

Who are we?

Orla Gavin

Partner, International Tax
KPMG in Ireland

T: +353 1 410 1202
M: +353 87 744 1202
orla.gavin@kpmg.ie

Orla has over 22 years experience with KPMG in advising a diverse range of Irish headquartered and multinational clients on all aspects of tax.

She has significant experience in the area of international tax structuring, intellectual property planning, cross border financing structures, exit planning, transfer pricing, profit repatriation strategies and tax optimisation in the context of supply chain management.

She is also a member of the M&A tax team and has experience leading due diligence assignments, including pre-deal structuring advice and post deal integration tax plans.

Significant experience advising Irish headquartered groups with international operations, and significant multinational groups with Irish operations.

Orla also manages the corporation tax compliance obligations of a number of large clients, and has significant tax accounting and tax compliance experience, having prepared the worldwide group consolidation for several large multinational organisations.

Stephen Massed

Principal, KPMG US
WNT, M&A Tax

T: +1 202 533 4738
M: +1 401 575 2836
smassed@kpmg.com

Steve is a member of the M&A Tax and International Tax groups of the Washington National Tax practice, and specializes in cross-border M&A transactions. Steve has advised KPMG clients on a wide array of international corporate tax matters, including cross-border joint ventures, restructurings, reorganizations, and spin-offs, inversions, U.S. income tax treaty application, subpart F, GILTI, planning, and debt-to-equity analysis.

Steve regularly speaks on cross-border M&A tax subjects at forums such as meetings held by the International Fiscal Association and the Tax Executives Institute and KPMG-sponsored client events. Steve has written several articles on cross-border M&A tax matters, including an outline on section 367 that is published annually in the PLI Corporate Tax Practice Series, is a key contributor to the PLI outline Corporate Distributions Under Section 355, and a co-author of the WG&L treatise U.S. Taxation of International Mergers, Acquisitions, and Joint Ventures.

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Who are we?

Matthew White

Principal, KPMG US
WNT, M&A Tax

T: +1 615 248 5514
M: +1 202 315 3484
matthewkwhite@kpmg.com

Matt is the Vice Principal in Charge of KPMG's U.S. and Global Complex Transactions Group. Matt advises KPMG clients on all aspects of corporate taxation, with a particular emphasis on spin-offs, mergers and acquisitions, restructuring transactions, debt and equity offerings, and consolidated returns. He also has significant experience with insolvent companies, cross-border transactions, regulated investment companies, real estate investment trusts, and financial instruments. He lectures frequently on various corporate tax issues and previously chaired the ABA's Affiliated and Related Corporations Committee.

Prior to joining KPMG in March 2013, Matt was a partner with McDermott Will & Emery LLP in Washington, D.C., where he led the tax department's corporate and consolidated group.

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Q&A

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