

Citi's Online Academy: Tax Challenges Across EMEA

24 November, 2009 at 3pm GMT / 10am EST

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Speakers

Mark Beard



- Mark heads the Liquidity and Investments product for Citi GTS in EMEA. He has over 18 years banking and treasury experience gained within the corporate and banking sectors and has held a variety of business development, consulting and core treasury roles in Europe, Asia, and North America. He has assisted many of the world's leading corporations to re-engineer their liquidity and treasury operations, and is a recognised authority on innovative working capital solutions. Mark gained practical corporate experience at IBM and at Ford Motor Company. Mark has an MBA from London Business School and a BSc. First Class in Mathematics & Engineering from University of Reading in the UK.
- mark.lindsay.beard@citi.com

Deborah Anthony



- Debbie is a Partner in Deloitte's tax practice since 2002 having previously been an Andersen partner. Debbie joined the tax practice of Arthur Andersen in 1984 and has worked with a broad range of multinational clients across industry sectors. Debbie formed Andersen's Treasury Tax Competency Team in 1999 and since then a significant amount of her work has been focused on treasury tax issues. As part of the Treasury Tax Competency Team, Debbie has worked on numerous cash pooling systems and other corporate tax issues arising for treasury departments. This team previously won Best Tax Advisor in the Treasury Management International Awards for Excellence in Cash and Treasury Management for five years running (most latterly in October 2003) and has established a reputation for offering workable and effective solutions which include covering both transfer pricing and VAT implications of any proposals.
- danthony@deloitte.co.uk

Stephen Weston



- Stephen is a Partner in Deloitte's Financial Services Tax group, who leads the firm's structured finance and treasury tax practice. He advises a number of Multinational Corporate (across a variety of industries including Utilities) and Financial Institutions in this area. This covers general advisory, planning transactions and dealing with subsequent HMRC enquiries. He also works closely with Delotte's Tax Policy Group to ensure compliance with the UK Disclosure regime with regard to such transactions. He is a qualified chartered accountant and a member of the Association of Corporate Treasurers.
- sgweston@deloitte.co.uk

Peter Badenhuisen



- Peter Badenhuisen is a Partner in the US Corporate Tax Services group based in London. He is qualified as a US certified public accountant (CPA) and his experience covers an array of US tax consulting and compliance issues across a broad range of industries, with particular focus on private equity and real estate investment funds. Peter has over 16 years' experience covering a wide variety of US domestic and international tax issues, including nine years in the UK. Since relocating to London in July 2000, he has been responsible for providing substantial US tax consulting and reporting services for numerous US inbound and outbound investment funds, with primary emphasis on US-based private equity and real estate funds with overseas properties.
- pbadenhuizen@deloitte.co.uk



Tax Challenges for Centralised Treasury Functions

24 November 2009 at 15:00 (GMT)

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Tax Challenges for Centralised Treasury Functions

Subsidiary funding and taxes

Treasury Objective	Tax Considerations
<p>Subsidiary capital structure</p> <ul style="list-style-type: none">• Prefer debt over equity to maximize interest expense deduction• Flexibility for debt waiver, debt for equity swaps, or recapitalization <p>Inter-company funding</p> <ul style="list-style-type: none">• High interest rate for countries with higher tax rate	<p>Thin capitalisation rules</p> <ul style="list-style-type: none">• Maximum debt over equity ratio for any legal entity in a country <p>Transfer pricing</p> <ul style="list-style-type: none">• Arms length interest rates between two related parties <p>Double tax treaties</p> <ul style="list-style-type: none">• Implication on reducing withholding taxes <p>US taxes on global income</p> <ul style="list-style-type: none">• CFC/Subpart F rules <p>Tax implications for debt waiver, debt for equality swaps or recapitalization vary by countries</p>

Tax Challenges for Centralised Treasury Functions

Subsidiary funding and taxes

Treasury Objective	Tax Considerations
<p>Cash pooling</p> <ul style="list-style-type: none">• Lend surplus funds from one subsidiary to subsidiary with deficit position• Agglomerate and control funds from all countries (where regulations allow) and business units• Concentrate funds in a low tax jurisdiction <p>Investments</p> <ul style="list-style-type: none">• Concentrate funds in major financial centers where there are more investment options• Invest centrally to maximize interest yield	<p>Interest deduction</p> <ul style="list-style-type: none">• Interest expense in non tax paying (deficit) entity whereas interest income in high tax paying entity (group taxes help neutralize) <p>Transfer pricing</p> <ul style="list-style-type: none">• Arms length interest rates between two related parties <p>Tax Havens</p> <ul style="list-style-type: none">• Low tax jurisdiction could be classified as tax haven and resulting implications <p>US taxes and global income</p> <ul style="list-style-type: none">• Foreign tax credits <p>Double Tax Treaties</p> <ul style="list-style-type: none">• Withholding taxes on interest for cross border fund movement <p>Other Taxes</p> <ul style="list-style-type: none">• Business Taxes on interest in countries such as China

Tax Challenges for Centralised Treasury Functions

Subsidiary funding and taxes

Treasury Objective	Tax Considerations
<p>Dividends</p> <ul style="list-style-type: none"> • Permanently repatriate subsidiary profits to the holding companies • Timing decision based on tax deferral principle – parent companies not taxed on foreign sourced income until they actually receive a dividend <p>Long-term upstream inter-company loan</p> <ul style="list-style-type: none"> • Need to have a strategy to unwind due to temporary nature of repatriation <ul style="list-style-type: none"> • Homeland Investment Act • Potential capex or acquisition from profitable subsidiary 	<p>Withholding taxes</p> <ul style="list-style-type: none"> • Interest expense in non tax paying (deficit) entity whereas interest income in high tax paying entity (group taxes help neutralize) <p>Double tax treaties</p> <ul style="list-style-type: none"> • Location of holding company • Implication on reducing withholding taxes <p>Tax Havens</p> <ul style="list-style-type: none"> • Holding companies in low tax jurisdiction could be classified as tax haven and resulting implications <p>US taxes and global income</p> <ul style="list-style-type: none"> • CFC/Subpart F rules • US shareholder taxed on overseas income of the firm when earned rather than deferral until receive dividend

Tax Challenges for Centralised Treasury Functions

Where to start if you want a centralised treasury function?

Feasibility study;

Consider - transaction analysis, Liquidity profile, Banking structure, Estimated savings = proposed structure

- Drive to have a centralised function is not for tax benefits
- Allows subsidiaries to concentrate on core activities (cost savings)
- Most important factor in choice of location of centralised function is not tax but existing corporate location
- Also consider regulatory environment, financial market liquidity and infrastructure

Tax Challenges for Centralised Treasury Functions

What will the Treasury Centre do?

Cash pooling

Factoring

Investment management

Intra group netting of net

Foreign exchange management

Tax Challenges for Centralised Treasury Functions

Challenges of centralised treasury functions - Context

Tax authorities are in revenue raising mode

“The harder line being taken by big western countries reflects their hunger for revenues to replenish treasury coffers that have been badly depleted by bank bail-outs and economic stimulus measures.”

Vanessa Holder
FT 17 November 2009

“Taking a leaf out of the US Department of Justice and Internal Revenue Service manual on intimidation, the Italians launched a co-ordinated raid on 76 Swiss banks in locations across northern Italy.”

Paul Betts
FT 3 November 2009

“With record deficits and a weakened economy, we owe it to honest taxpayers to set an aggressive agenda that puts an end to offshore tax evasion once and for all.”

Max Baucus, US Senate Finance Committee chairman
Bloomberg 17 October 2009

Tax Challenges for Centralised Treasury Functions

Challenges of centralised treasury functions - Context

Payment of tax has become a moral/reputational issue

How? Examples:

Tax on Board Room agenda in UK and elsewhere

- Senior Accounting Officer legislation in UK

President Obama's regime comments:

“Treasury secretary said the US is taking steps to end the “indefensible” tax breaks and loopholes that have unfairly benefited certain companies and rich individuals”

(Telegraph 4 May 2009)

Channel Islands – told by British Treasury Minister that their corporate tax system, under which many companies pay no tax, is unacceptably predatory

Tax Challenges for Centralised Treasury Functions

Context

Is this the next political debate on tax?

Debt or equity?

International Monetary Fund Fiscal Affairs Department produced the following paper in June 2009:

Debt Bias and Other Distortions: Crisis-Related Issues in Tax Policy

It begins:

“Tax distortions are likely to have encouraged excessive leveraging and other financial market problems evident in the crisis. These effects have been little explored, but are potentially macro-relevant. Taxation can result, for example, in a net subsidy to borrowing of hundreds of basis points, raising debt-equity ratios and vulnerabilities from capital inflows.”

Tax Challenges for Centralised Treasury Functions

Context

“Our corporate sector's excessive dependence on **debt** is deep rooted in the structure of our economy. In particular, economists have long pointed out that our corporate tax system favours **debt** financing over equity. **Interest** costs are fully deductible with very limited restrictions, while the returns on equity receive little or no **tax relief.**”

“The result is that the UK is widely regarded as having the most generous **tax** treatment of **debt interest** of any major economy. That's economically inefficient at the best of times, but it makes even less sense now that we understand more about the dangers of excessive leverage. There are several ways that we could begin to undo this imbalance by reducing the costs of equity financing relative to **debt.**”

“... I believe the time has come to look again at the generosity of **interest** deductibility in our corporate tax system.... by reducing the **tax** breaks for **debt** ---”

George Osborne MP, Friday, March 6 2009

Tax Challenges for Centralised Treasury Functions

Context

How is more tax to be collected in current economic climate?

Tax authorities will make use of the information available to them such as

- FIN 48 in US
- Sch 36 information request in UK
- Qualifying Intermediary rules
- FATCA 2009 (Foreign Account Tax Compliance Act of 2009)
- In the UK, arrangements that enable a person to obtain a tax advantage ('schemes') have to be disclosed to HM Revenue & Customs (HMRC)
- Advance pricing agreements

More information is available to the Tax Authorities than ever before.

Tax Challenges for Centralised Treasury Functions

Recent developments

How is this revenue drive reflected in recent developments in legislation?

- **Beneficial ownership** - Case law
Substance has become crucial
- **Tightening up of Thin capitalisation and Transfer Pricing legislation**
- Thin capitalisation
 - New legislation on interest deductions – UK, Netherlands, Germany
- Transfer pricing
 - Generally documentation requirement more onerous
 - More detailed transfer pricing work required

Tax Challenges for Centralised Treasury Functions

Recent developments- beneficial ownership

OECD Commentary

Where an item of income is received by a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the immediate recipient of the income as a resident of the other Contracting State.

... It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a **conduit** for another person who in fact receives the benefit of the income concerned. ...

a **conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.**

Tax Challenges for Centralised Treasury Functions

Recent developments- beneficial ownership - Indofood

- No spread or margin in financing subsidiary
- Must pay-on interest receivable from parent: in fact, funds bypassed financing subsidiary
- Only obliged to pay noteholders out of proceeds receivable from parent

“... though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.”

(OECD Commentary)

Tax Challenges for Centralised Treasury Functions

Recent developments- beneficial ownership – Indofood

Impact

- Public bond market has adapted
- OECD guidance “conduits” endorsed
- More emphasis on substance

Tax Challenges for Centralised Treasury Functions

Recent developments beneficial ownership

Indicators of substance

- An office (not just a letter box or a “desk” at a service provider)
- Fully equipped (i.e. telephone line, IT equipment, office equipment, filing facilities.)
- A name plate must be clearly visible
- Board meeting of Directors should take place in relevant country;
- Meetings should be substantive
- The decisions not in any way preordained.
- The majority of board members should be resident in the relevant country.
- The board members should be individuals with sufficient expertise and experience.
- Telephone conferences from other jurisdictions should be avoided.
- All relevant documentation should be kept in relevant country.
- Secretarial function should be carried on in relevant country.
- Meetings should be minuted in sufficient detail to provide evidence of substantive consideration of the issues before the Board and decisions made.
- The Treasury centre company must itself take the strategic decisions.
- Where there is delegation the managers should regularly approve the executed tasks.

Tax Challenges for Centralised Treasury Functions

Recent developments: Thin capitalisation and Transfer Pricing legislation

Interest limitation

- Germany introduced a new system of interest limitation rules for financial year 2008 onwards.
- Italy also introduced new interest limitation rules for this period.
- The Austrian Ministry of Finance published an opinion concerning applicable interest on (cross border) intragroup loans in April 2008.
- Finland plans to introduce thin capitalisation rules in 2010 or 2011.
- UK introduced world wide interest cap from 2010.
- Proposed new rules on interest deduction in the Netherlands. (Expected to be effective 1 January 2010).

Tax Challenges for Centralised Treasury Functions

Recent developments: Thin capitalisation and Transfer Pricing legislation

UK world wide interest cap

- The debt cap will apply to large groups for accounting periods beginning on or after 1 January 2010.
- To fall into the legislation a “gateway” test has to be failed.

The disallowance

- Broadly this compares an accounting measure of interest for the worldwide group with the UK tax measure of interest. To the extent the UK tax measure of interest exceeds the accounting measure there will be a disallowance of interest for tax purposes in the UK.
- Negative net interest (that is, income) this is not included in the UK Tax measure of interest.
- Treasury companies should often fall outside of the rules (i.e. will not contribute to the UK tax measure of interest) if they have net income.
- Where a Treasury company has net interest expense the tax deduction for this could be restricted.
- By election financing expenses and income of group treasury companies can be excluded from being taken into account in computing the amounts referred to above. To make this election a company must have at least 90% “group treasury revenue.”
- There were originally issues with this election as treasury companies in a group had to be aggregated, on 9 November the Financial Secretary to the Treasury announced the Government’s intention to change this.

Tax Challenges for Centralised Treasury Functions

Recent developments: Thin capitalisation and Transfer Pricing legislation

Documentation

- Greece introduced documentation requirements for fiscal periods ending 18 December 2008
- Slovakia introduced an obligation to prepare upfront transfer-pricing documentation on the transfer pricing method used in the documented transaction from 1 January 2009.
- Hungary is changing the transfer pricing documentation rules effective 1 January 2010
- France – in October 2008 draft documentation rules were introduced. These were revised in 2009 and are expected to take effect in 2010.
- Finland and Sweden both introduced transfer pricing documentation requirements from 1 January 2007.
- Singapore issued transfer pricing guidance (including guidance on documentation) in 2006. In July 2008 a circular on transfer pricing consultation was published; the objectives being for the Singapore tax authorities to assess taxpayers transfer pricing risks, review their documentation and provide recommendations for managing risks.
- New Chinese draft transfer pricing regulations were issued in spring 2008 which include new contemporaneous documentation requirements for related party transactions.

Tax Challenges for Centralised Treasury Functions

Recent developments: Thin capitalisation and Transfer Pricing legislation

General comment

- Very broadly most eastern European countries tend at present to follow OECD guidelines with more sophisticated documentation requirements a feature of more “developed” regimes .

General recent developments

- Turkey – in 2009 long awaited legislation came in to force effective from 2007 empowering the tax administration to make assessments based on transfer pricing.
- Russia – in April 2009 new draft legislation was introduced, expected to take effect in 2010.

Tax Challenges for Centralised Treasury Functions

Usual treasury centres – UK, Netherlands, Luxembourg and Ireland

UK headquarter companies usually have a UK Treasury centre

Pool Header Location	Netherlands	Ireland	Luxembourg	UK
Is a tax ruling possible?	Yes	A ruling is available on whether the company is trading.	Yes	Not usually
Is Pool Header taxed on the margin earned?	Yes	Yes, but may not be considered trading therefore no relief for expenses.	Yes	Yes
Local presence required?	Yes	Yes	Yes	Yes
Is double tax relief for WHT suffered available?	In practice no. Local tax is only paid on the margin retained by the Pool Header leaving little capacity for DTR.	In practice no. Local tax is only paid on the margin retained by the Pool Header leaving little capacity for DTR.	In practice no. Local tax is only paid on the margin retained by the Pool Header leaving little capacity for DTR.	In practice no. Local tax is only paid on the margin retained by the Pool Header leaving little capacity for DTR.

Tax Challenges for Centralised Treasury Functions

Focus on cash pooling

Cash pooling – which countries should participate?

Issues:

- WHT (Is this suffered?)
- DTR (Can this be claimed?)
- Regulatory
- Transfer Pricing and Thin Capitalisation
- Stamp duty and other capital taxes and levies such as Turkish Resource Utilisation Support Fund (RUSF)
- Tax deduction for interest – At passive or trading rate?
- If a notional pool, are the payments legally interest ?
- Permanent Establishment – of participants of cash pool in Pool Header country or of Pool Header company in pool participants country?

Tax Challenges for Centralised Treasury Functions

Focus on cash pooling

Heads up on “tricky” countries to include in a pool

- Greece - Stamp duty (Loan agreements between corporate entities which relate to movable or immovable property located within Greece or entail obligations executed within the Greek territory are subject to a 2.4% stamp duty charge in Greece)
- Portugal - Stamp duty
- Austria – Stamp duty (Loan contracts are subject to stamp duty. The applicable rate will be either 0.8% or 1.5%. The rate for stamp duties amounting to 0.8% applies for loans, when the borrower can dispose over the loan amount only once or more times if the loan contract was concluded for maximum of five years. For all other loan contracts the stamp duty amounts to 1.5% of the loan sum. Stamp Duty can normally be avoided with careful planning.)
- Poland - ‘Tax on civil law transactions’. The rate for loan agreements is 2%.
- Turkey - Exchange control and RUSF (Resource Utilization Support Fund (RUSF) is a levy which was introduced in the 1980’s by the Central Bank. It is charged on both loans from abroad and loans obtained locally. It does not apply to foreign loans with an average maturity of more than one year. The application of RUSF on cash pooling structures is not very clear at present and therefore it creates a hurdle for cash pooling. The rate of RUSF varies between 0% and 15% on the principal amount.)

Tax Challenges for Centralised Treasury Functions

Focus on cash pooling

Practical tips?

Tax avoidance not a driver

How much work is required on transfer pricing?

Well understood in Western world but not everywhere!

Tax Challenges for Centralised Treasury Functions

Focus on cash pooling

Can the US join a cash pool?

Issues: For a US subsidiary of a non-US parent as pool participant

- “Earnings stripping” interest expense limitations (thin capitalisation)
- Anti “conduit financing” rules could re-cast US WHT position / treaty eligibility
- Transfer pricing likely to be challenged / scrutinised
- Debt/equity characterisation, e.g. if US subsidiary deemed not to have the capacity to borrow on a stand-alone basis, then (a) could lose interest deduction if advances to US viewed as equity, and (b) distributions could be treated as dividends subject to WHT.

Tax Challenges for Centralised Treasury Functions

Focus on cash pooling

Can the US join a cash pool?

Issues: For a non-US subsidiary of US parent

- CFC – Subpart F / “anti-deferral” rules
- Section 956 – loans (or deemed loans) may be re-cast as deemed dividends, or “anti conduit” could re-cast or group separate loan arrangements amongst controlled groups
- Complex transfer pricing issues
- Currency issues, e.g. net exchange gains of lenders may be viewed as deemed dividends under Subpart F, whereas net exchange gains of borrowers may only trigger deemed dividends in proportion to the borrower’s other income subject to deemed dividend treatment.

Tax Challenges for Centralised Treasury Functions

CFC / Subpart F

- U.S. corporations are generally not taxed on business income of their foreign subsidiary corporations until the earnings are either repatriated or gains are recognized from the sale of shares by the U.S. shareholder (commonly referred to as “Deferral”)
- However, certain types of income are not eligible for deferral
- These types of income are deemed repatriated to the U.S. corporation
 - Subpart F (taxed by U.S. in the year earned)
 - Investments in U.S. property (“Section 956”)

Tax Challenges for Centralised Treasury Functions

CFC / Subpart F

- Subpart F income is a list of different categories of income that Congress determined should not be eligible for deferral for various policy reasons
- Two step process to determine whether income is Subpart F:
 - 1) Characterize income (e.g. dividend, royalty, services or sales income)
 - 2) Apply the appropriate Subpart F rule
 - a) Foreign Personal Holding Company Income (FPHCI)
 - b) Foreign Base Company Sales Income (FBC Sales Inc)
 - c) Foreign Base Company Services Income (FBC Services Inc)
- Foreign Personal Holding Company Income
 - Passive income (dividends, interest, rents, royalties, annuities)
 - Some exceptions (e.g. active rents & royalties, same country income, etc.)

Tax Challenges for Centralised Treasury Functions

CFC

UK CFC position has changed recently due to;

Cadbury

The ECJ held in *Cadbury Schweppes* that the UK controlled foreign company (CFC) legislation was in principle in breach of the right to freedom of establishment under Article 43 of the EC Treaty but was acceptable if it only applied to wholly artificial arrangements where the CFC carried on no genuine economic activities in the member state where it was established.

The question remitted back to the UK courts in *Cadbury Schweppes* was whether the UK's CFC motive test could be interpreted so as to disapply a CFC charge in these circumstances.

Vodafone 2

Vodafone 2 claimed that the tax was not payable because the CFC rules were contrary to EC law and therefore could not be applied to it. The High Court held that the CFC rules should be disapplied in their entirety for UK companies with subsidiaries in EU/EEA member states. Reversing the decision of the High Court, the Court of Appeal in *Vodafone 2* held that it was possible to interpret the CFC legislation so as to bring it in line with freedom of establishment by reading in a restriction that the CFC regime would not apply to companies established in other member states which carried out genuine economic activities.

We expect *Vodafone 2* to be decided ultimately by the House of Lords.

Obama / US legislative 'state of play'



Tax Challenges for Centralised Treasury Functions

Obama / US legislative ‘state of play’ - Background

- On February 26, 2009, President Obama released an outline of his budget proposal for the 2010 fiscal year. It included a tax proposal to “implement international enforcement, reform deferral, and other tax reform policies”, raising \$210 billion over 10 years, without any greater description. The revenue breakdown is provided below:

Obama Budget Outline	2009	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	Total
International enforcement, reform deferral, and other tax reform policies as included in the Greenbook (in billions)	--	2	14	20	21	22	24	25	26	27	29	210
JCT Estimates	--	--	10	17	16	17	18	19	20	21	22	159.3
Mid-Session Review	--	2	10	14	15	16	17	18	18	19	21	150.9

- On May 4, 2009, the President held a news conference to announce additional details of the international tax proposals. The additional detail provided by the Administration accounted for \$198.3 billion of the total to be raised and five proposals.
- On May 11, 2009, the Treasury Department released the Greenbook with additional details regarding the Administration’s proposals and seven new international tax proposals.
- On August 25, 2009, OMB released a mid-session review of the budget for Fiscal Year 2010.
- On September 14, 2009, the JCT released a report on the Administration’s proposals.

Tax Challenges for Centralised Treasury Functions

Potential Economic Implications

Administration's View

Create US jobs

Provide incentives for investing in US

Raise revenue by closing "loopholes"

Business View

Encourages movement of jobs offshore – loss of tax deductions (US based SG&A)

Raises US cost of capital since US interest expense not fully deductible

Encourages cash to remain offshore due to increased tax on repatriation; reduces ability to efficiently deploy capital globally

Limits ability of US multinationals to reduce local country income tax

Effect on Multinational Competitiveness

Tax Challenges for Centralised Treasury Functions

Obama / US legislative 'state of play' - Timing

- Ultimately, a number of political variables will affect the likelihood and timing of Congressional action on these proposals
- The size and scope of these proposals is substantial, and together with other legislative priorities will place tremendous pressure on Congressional capacity well into 2010
- Substantial tax law changes will be delayed until after the President's tax reform panel (chaired by Volker) releases their recommendations on December 4, 2009
- JCT Description (released September 9, 2009) expands on many of the initial concepts of the Obama proposals
- Meaningful reform not expected until late 2010 or 2011, although some measures (e.g., codification of economic substance and other anti-abuse legislation) could move sooner
- WSJ article on October 14, 2009 reported "that the Obama administration has shelved the proposed tax revenue raisers following a blitz of complaints from businesses. Obama aides say the administration has set aside the idea for now, but may return to it as part of the broader tax overhaul sometime next year"

Questions & Answers

Please feel free to engage us and ask questions regarding the treasury related concerns.

Thank you



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