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Restructuring a Multinational Corporation to Optimize Profitability and Efficiency

A Case Study

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2022 Revised Edition

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The TO Project

A few years ago, I was asked to serve as lead outside legal counsel to a U.S.-based public corporation in an industrial business sector with operations in over thirty countries in the reorganization of its global corporate structure and operations. The object of the restructuring was to align the corporate structure with a recent reorganization of the company along regional and business unit lines. Through this realignment, the company expected to derive substantial business benefit through greater transparency in reporting lines, improved oversight as well as increased operational efficiencies. We called this significant global project "territorial optimization," or the "TO Project."

The TO Project was structured to use the so-called "Swiss principal" or "principal" model, one of several restructuring models then possible. It is important to state at the outset that under pressure from the Organization for Economic Cooperation and Development ("OECD"), the Swiss Federal Tax Administration ("SFTA") as of January 1, 2019 sunset the availability of new special local Swiss Cantonal tax rulings that made the Swiss principal model particularly attractive, with existing (previously granted) tax rulings sunset as of January 1, 2020. However, although those Swiss tax incentive aspects of the Swiss principal or principal model are no longer available, many of the techniques and lessons learned in the TO Project remain relevant to

multinational companies seeking to optimize their profitability and efficiency, and will be covered here.

In a principal structure, the corporate group's local buy/sell companies, usually subsidiaries or unincorporated divisions, but theoretically also unaffiliated distributors, are replaced by one principal Switzerland- or other country-based company facing third party customers and vendors. It should be noted that a principal structure could be established in jurisdictions other than Switzerland that met some or all of Switzerland's attributes, such as a business-friendly environment, advanced body of commercial law that provides certainty in strategic planning, financial services center status, low tax rates, and strategic regional location. In fact, our project established not only a Swiss principal, but a U.S. principal to face the U.S. market and made provision for a future "Asian principal" in Singapore for Asia-facing operations.

The corporation that decided to undertake the TO Project was a mature company in its core businesses, but was also engaged in a transition from an industrial manufacturing to a high technology enterprise. Like many other public companies with global operations and multi-billion dollar market capitalizations and revenues, the company had grown substantially without always optimizing its own corporate structure, although it had operated internationally for many years.

The company had grown through acquisitions over the years, caching its acquisitions in various places in the corporate structure that

made sense at the time but which had grown unwieldy. For example, all procurement from upstream vendors was handled out of the United States, even when the vendors were in the EMEA (Europe-Middle East-Africa) region and their products, once shipped to the U.S., were combined into finished products to be sold back into the EMEA region. The client determined that it could no longer efficiently conduct its business with a formal corporate structure that was so disjointed from the structure it had chosen to optimize its business operations.

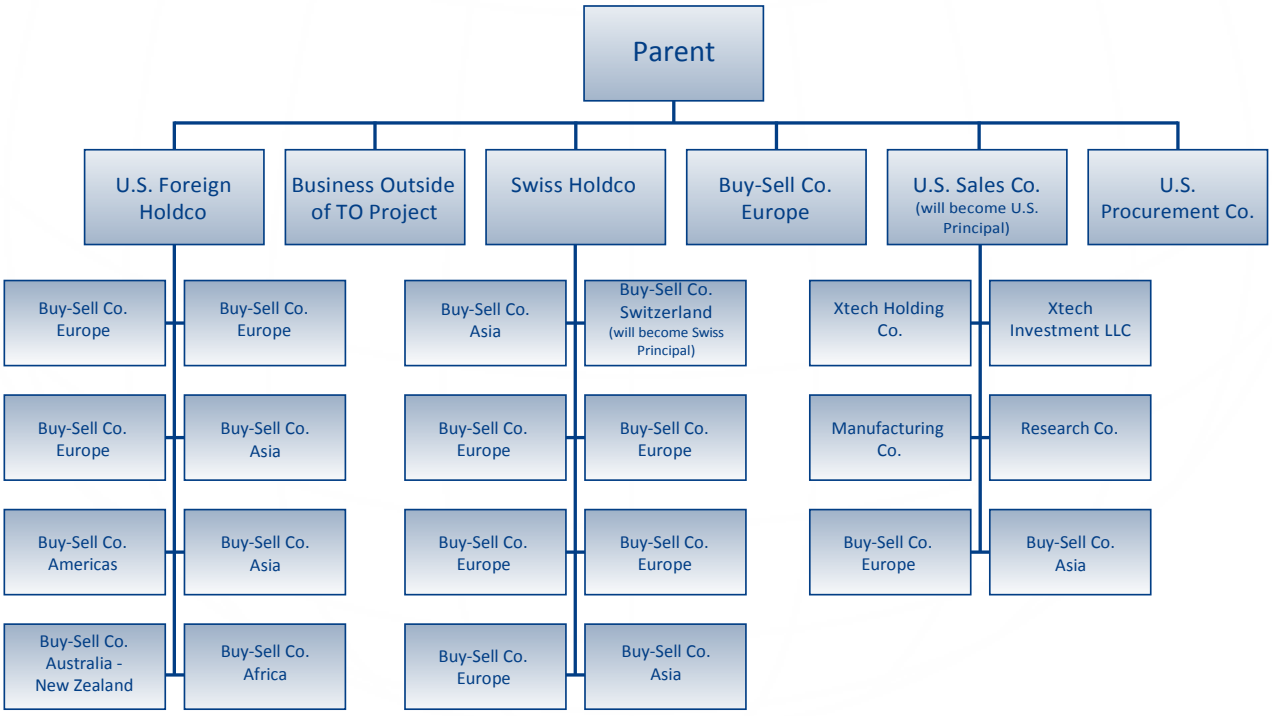
The parent corporation ("Parent"), a Delaware corporation and the registrant under the Securities Exchange Act of 1934, had a set of direct subsidiaries under it, including a U.S. operating sales corporation that also held a number of operating subsidiaries, both domestic and foreign ("U.S. Sales Co."); a U.S. corporation to handle procurement; a U.S. corporation that served as a holding company for non-U.S. operating subsidiaries ("U.S. Foreign Holdco"); and a Swiss corporation that held other non-U.S. holding and operating subsidiaries ("Swiss Holdco"). Some of the operating subsidiaries in a second, third or fourth tier below Parent had a second, minority shareholder in the corporate group as a result of local laws requiring at least two shareholders.

The TO Project's ultimate task was to rationalize this structure through the creation of two holding company subsidiaries of Parent, one a direct subsidiary that would face the U.S. market ("U.S. Principal"), and the other an indirect subsidiary under Swiss Holdco, that would also be based in Switzerland and face the non-U.S. market ("Swiss Principal"). Both

U.S. Principal and Swiss Principal would be converted from corporations to the U.S. and Swiss equivalents of U.S. limited liability companies ("LLCs"), which, under Internal Revenue Code ("IRC") "check-the-box" rules, would become disregarded entities not subject to U.S. taxation at their own level, but able to "pass through" their profits and losses to their owners in the same way as partnerships.

Figure 1

Simplified Diagram of Corporate Structure at Beginning of TO Project



Global buy-sell companies are scattered through corporate structure, subsidiary to U.S. Foreign Holdco, Swiss Holdco, U.S. Sales Co. and even Parent.

Under U.S. Principal and Swiss Principal would be the local operating companies, called "country distributors," or "CDs." To the extent the CDs were already subsidiaries of Swiss Holdco, they would be contributed downstream to Swiss Principal. To the extent any CDs were not subsidiaries of Swiss Holdco, they would have their shares contributed to Swiss Principal in a two-step process separated by months, from Parent, U.S. Principal or U.S. Foreign Holdco to Swiss Holdco, and then from Swiss Holdco down to Swiss Principal. In some cases, a three-step process, first distributing the CD up to U.S. Sales Co., U.S. Foreign Holdco or even Parent before contributing the CD to Swiss Holdco and then down to Swiss Principal, was necessary because of where that operating company had been lodged in the pre-existing corporate group structure. The CDs in each jurisdiction would also be converted to LLC equivalents under the local law under which each was formed, allowing them to be treated as pass-through entities for U.S. tax purposes. Again, the purpose of the shifting of ownership of the CDs was to create a formal corporate organization that matched up with the manner in which the business was being operated and while the changes may seem complicated, with good planning and coordination all of the transfers were completed on time and under budget.

The Team

Given that the TO Project was among the company's major strategic

initiatives, it required buy-in and support at the company's highest levels. This buy-in required assessment of the business case for the restructuring, for example, the efficiencies in procurement, manufacturing and distribution cost, time and work flow to be gained by procuring locally from upstream vendors in the EMEA region products that were to be processed and resold in the same region by the insertion of Swiss Principal into the center of the process. A careful review also was had on the impact of the reorganization on customer-facing activities as well as possible registration changes in licenses, importers-of-record and intellectual property. A significant intra-company education effort was undertaken, explaining to local managers what the TO Project would mean for their operations, how it would improve efficiencies and profitability as well as streamline logistics for them.

A working group, led by a senior European manager, was assembled from internal resources and included representatives from the company's information technologies group, controller's office, representatives from the business units, the legal and tax team, as well as systems, regulatory and compliance specialists. On the legal and tax team, the General Counsel, the Director of Tax, and the directors of international and domestic tax were key players. Also on the team were the controllers or managers of each local subsidiary, as well as local counsel in each jurisdiction in which the company's affiliates operated. I was engaged as lead outside counsel to run the legal aspects of the project worldwide, reporting to

the General Counsel, working in tandem with the Director of Tax and the international and domestic tax directors, interfacing with the local controllers and supervising local counsel on six continents, which included engaging new local counsel where a pre-existing relationship did not exist or was thought to be unsuitable. Supporting the project were a team of outside international accountants and a team of consultants, responsible for a number of activities, including the design of the supply chain and ensuring the final structure met accounting and fiscal requirements. Communication was obviously key in so complex a project and so large a team. A virtual "deal room" was set up, collaborative project management software was employed and weekly conference calls were scheduled.

Key customers and vendors were consulted early in the process, to assure them that the process would not affect the company's relations with them and, in some cases, to obtain their prospective consent to the assignment of a contract to a new counter-party. Handled in this way, customer and vendor relations were rarely a sticking point.

The design of the TO Project was a highly creative process. The team created, and frequently revised, a large PowerPoint slide deck encompassing three years of staged legal transactions that diagrammed each step of the TO Project on a separate slide, showing each transaction's process and resulting structure. Because of the imperative to enhance operational efficiency, care was taken to include in the restructuring only those companies involved in buy-sell operations on a regional basis, as

the disconnect in current versus desired structure was greatest there. Some companies involved in non-core businesses, for example, some research and development facilities, were not included. In addition, an intellectual property and regulatory review was undertaken for all included companies to make sure that any required assignment or modification of patents, trademarks or licenses, whether for manufacture, importation, exportation, or otherwise, were front-loaded so as to be in place or ready when needed further on in the project. In one or two cases, regulatory hurdles appeared sufficiently risky that the company involved was excluded from the TO Project, at least for the time being. In others, resolution of the intellectual property or regulatory issues appeared so time-consuming and/or expensive that the involved companies were excluded from the project for that reason. This review was a key to the ultimate success of the reorganization and planning, both in terms of resources and budget and proved to be critical in keeping the total project on time and within budget.

Structuring U.S. Principal

The first step in the project was to structure U.S. Principal. U.S. Sales Co. was chosen as the vehicle for U.S. Principal as it was already an operating company that also held many of the assets that U.S. Principal was intended to hold. Before U.S. Principal could be formed, and as part of the organizational rationalization mission of the project, U.S. Sales Co. had to spin off some U.S. and non-U.S. subsidiaries which were not

core to its eventual mission as U.S. Principal.

Whenever one embarks on the restructuring of a global corporate organization, one of the key challenges is to address possible tax consequences arising out of the various transfers required to reach the desired end result. The tax codes in most countries recognize reorganizations that are based on sound business reasons, such as the one at issue here, and provide mechanisms which, if properly structured and implemented, will enable the reorganization to be carried out with minimal tax- related impact. Careful planning and close consultation with consultants is essential to develop both a structure and implementation plan that satisfies tax policy in the jurisdictions at issue.

My first task was to distribute the equity of a few subsidiaries from U.S. Sales Co. up to it. One series of transactions is illustrative. U.S. Sales Co., which was incorporated in a western state, had a group of technology-specialized companies under it, deriving from another acquisition. In the structure, U.S. Sales Co. held the equity of one limited liability company called "Xtech Investment LLC" and one corporation called "Xtech Holding Co." The two companies were formed in a second western state. In turn, Xtech Investment LLC held 95% and Xtech Holding Co. held 5% of the partnership interests of a limited partnership ("Xtech LP") that was formed in yet a third western state, which was the operating entity of the Xtech group.

In order to achieve a "tax-free" "liquidation" of the Xtech group under IRC §332, which allows the complete liquidation of subsidiaries without gain or loss being recognized (for Xtech Holding Co.) and §708, permitting termination of a partnership (for Xtech LP; Xtech Investment LLC was already a disregarded entity), a number of requirements had to be met, not the least of which was following a careful order of operations. First, Xtech Holding Co. was liquidated and dissolved pursuant to a "plan of liquidation" as provided by §332; its 5% interest in Xtech LP was distributed to its parent, U.S. Sales Co. Second, the same operation was performed with Xtech Investment LLC; its 95% interest in Xtech LP was

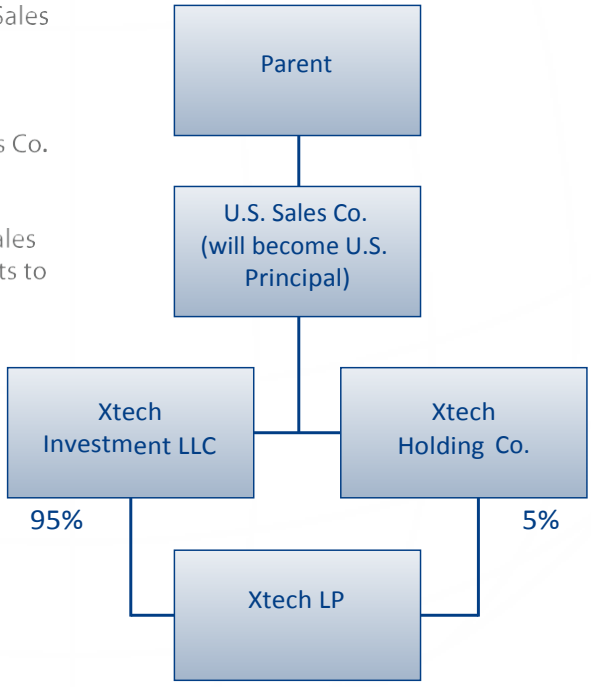
Figure 2

Simplified Diagram of Xtech Group Transactions

1- Xtech Holding Co. liquidates into U.S. Sales Co. and is dissolved.

2- Xtech Investment LLC (already a disregarded entity) liquidates into U.S. Sales Co. and is dissolved.

3- Xtech LP, now wholly owned by U.S. Sales Co., terminates and distributes its assets to U.S. Sales Co.



distributed to U.S. Sales Co.

At that point, U.S. Sales Co. held 100% of Xtech LP's partnership interests, meaning, that for purposes of §708, Xtech LP was no longer a partnership, since it had only one owner. Third, and finally, Xtech LP was dissolved and its assets distributed up to its parent, U.S. Sales Co. No taxable gain or loss on Xtech LP's dissolution and distribution of assets was realized by its partners, per IRC §731. These operations required coordination of all three western states' company laws for mergers, dissolutions and windings-up, in one case of a corporation, in another of a limited liability company and in another of a limited partnership. As a practice pointer, we opted to conduct the three operations on three successive days, because not all the jurisdictions' secretaries of state offered time stamping as well as date stamping and we wanted to leave no doubt that we had conducted the operations in the requisite order.

With the Xtech group and several other divestitures and group simplifications complete, our next step was to create a Delaware corporation ("U.S. Principal Delaware Mergerco"), wholly owned by Parent, into which U.S. Sales Co., incorporated in a state other than Delaware, would merge. To comply with IRC requirements, another "plan of liquidation" had to be drafted for U.S. Sales Co. Because U.S. Sales Co.'s state of incorporation's merger statute did not permit a short-form merger with a Delaware corporation, a full plan of merger had to be adopted. Once the certificate of merger in Delaware was issued,

we converted U.S. Principal Delaware Mergerco to an LLC under the Delaware corporation and limited liability company statutes, a two-day, two-step process resulting in U.S. Principal's creation in the form of a Delaware LLC, holding the assets of U.S. Sales Co. U.S. Principal was then renamed and an LLC operating agreement, directors and officers put in place. Finally, U.S.-facing subsidiaries under U.S. Principal were converted to LLC equivalents so as to be disregarded entities.

The series of operations to create U.S. Principal met the requirements of an "upstream C" reorganization under the IRC. Section 368(a)(1) of the IRC provides seven methods for structuring "tax-free" business combinations or divestitures. The forms are known by the letters A - G of the subsection pertaining to them. Generally, §368(a)(1) tax treatment is only available if the business combination provides a continuity of interest of the target's and purchaser's shareholders in the combined company, meaning in practice that at least a majority of the acquisition consideration must be in stock; a continuation post-acquisition of the target's business enterprise and a valid business purpose to the transaction (not mere tax avoidance). As mentioned earlier, the TO Project was conceived, developed and implemented for the purpose of improving control over and results of the business of the company by realigning the formal legal structure with that of how the business was to be managed going forward. As mentioned earlier, there were many specific business benefits, among them the supply chain efficiencies, both on the "upstream" procurement

side and on the "downstream" sales side, which also fully supported the business case for each transaction comprising the TO Project and the project as a whole. Each subsection's special requirements must also be followed. The "C" reorganization is functionally an asset purchase; to qualify, the purchaser, using only its voting stock, must acquire "substantially all" of the target's assets. Purchaser can use an 80% or more directly owned subsidiary to acquire target's assets in exchange for purchaser voting stock. The "C" reorganization amounts to a *de facto* merger of target into purchaser or purchaser's subsidiary. Under §368(a)(1)(A), "tax-free" reorganization treatment is also available for a statutory merger or consolidation under any state's merger statute. Once again, careful planning to ensure compliance with both tax codes and policy was instrumental in effecting the reorganization.

Creation of Swiss Principal

Because Swiss Principal was to be a wholly owned subsidiary of Swiss Holdco, an existing Swiss Holdco subsidiary was selected for the role. The subsidiary's assets were contributed to sister companies and it was renamed and converted to a "Gesellschaft mit beschränkter Haftung," commonly abbreviated as "GmbH," the Swiss/German equivalent of an LLC, so as to be a disregarded entity for U.S. tax purposes. With this step, both U.S. Principal and Swiss Principal were fully formed and organized. A new Swiss company was formed subsidiary to Swiss Principal to function

as a CD for the Swiss market.

Contribution and Conversion of non-U.S. Subsidiaries

The heart of the project was the conveyance of the non-U.S. subsidiaries to Swiss Principal, in most cases in a two-step process, first to Swiss Holdco, then to Swiss Principal and then the conversion of the CDs into disregarded entities for U.S. tax purposes. These transactions were intended to qualify as IRC §368(a)(1)(C) triangular reorganizations. In almost all cases, the non-U.S. subsidiaries were held by U.S. Foreign Holdco, in a few others by U.S. Principal and in two cases by Parent itself. A few non-U.S. subsidiaries were already held by Swiss Holdco; only a late stage, one-step procedure would be necessary to contribute those subsidiaries down to Swiss Principal. The first step in the two-step process was therefore a share contribution by one of the U.S. companies ("Contributor") to Swiss Holdco, a Swiss company ("Recipient") of its shares in the non-U.S. subsidiary ("Target") in exchange for shares of Recipient that would be authorized and issued to Contributor. A feature of Swiss corporate law prevented the authorization of shares before their issuance and required that only shares with a fair market value equal to their *pro rata* proportion to Swiss Holdco's assets could be authorized and issued. Therefore, each contributed Target had to be valued within a short period in advance of the transaction to determine how many shares of Swiss Holdco ("Consideration Shares") should be

issued to Contributor in exchange for its contribution to Swiss Holdco of Target's shares. Every time Recipient was to issue shares to Contributor, it had to conduct a "capital increase" reflecting the increase in its value occasioned by the contribution of Target's shares. Because of the *quasi in rem* nature of company shares, in many cases the share contributions had to be conducted under the corporate law of Target's jurisdiction. Swiss law is agnostic on the choice of law, so in the cases in which Target's jurisdiction did not have to be the governing law, the U.S. law jurisdiction of Contributor was chosen.

The peculiarities of the various CDs, acquired over the years and formally held in a corporate structure more for convenience than by design, can require a significant amount of creativity if one hopes to effect transfers that reduce cost yet still comply with tax law and policy. In our reorganization, we made use of triangular "C" reorganizations under IRC §368(a)(1); "D" reorganizations, a rarely used format in which a corporation acquires "all or a part" of another corporation's assets and, immediately following the transfer of assets, the transferor or one or more of its shareholders controls the transferee corporation; "B" reorganizations, in which a corporation acquires, solely for it or its parent's voting stock, 80% or more of the target's voting stock and the target becomes the purchaser's subsidiary; and "E" reorganizations, which permits recapitalizations in the form of stock-for-stock or debt-for-debt exchanges without recognition of taxable gain or loss, to facilitate

use of Swiss Principal stock as Consideration Shares for some of the CDs with comparatively lower valuations.

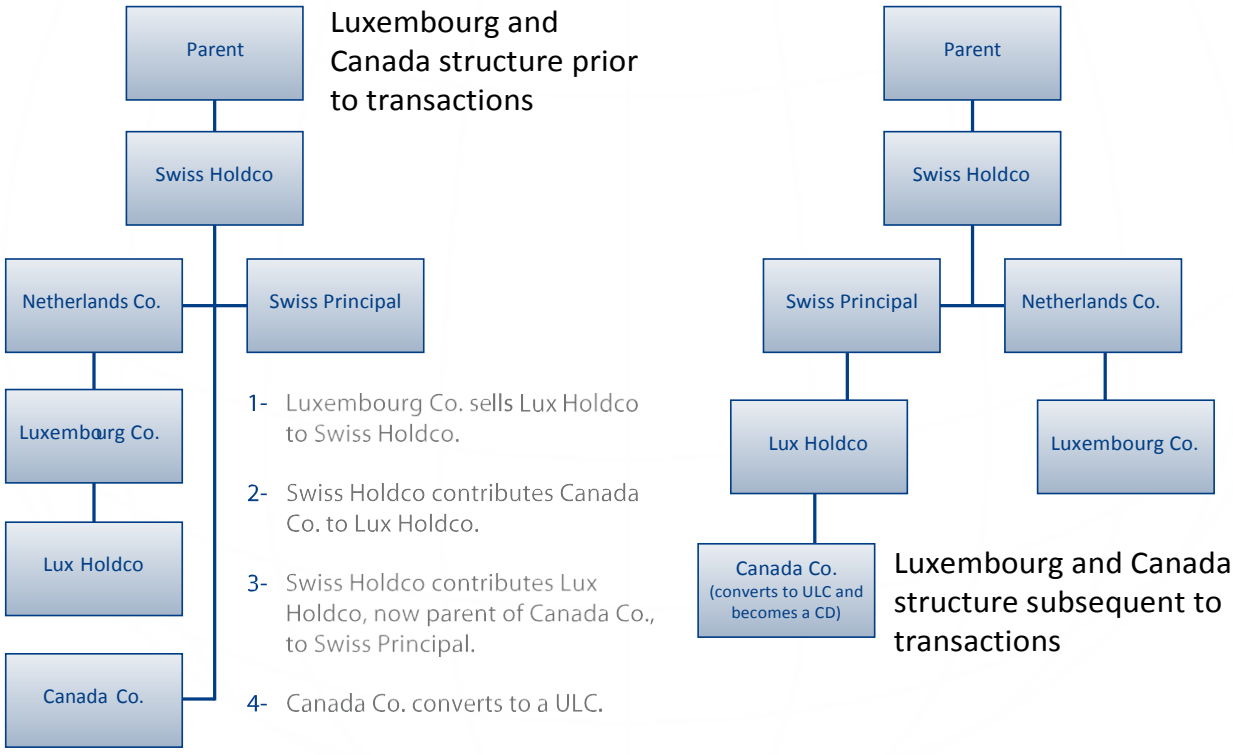
In addition to the U.S. tax considerations, legal and tax advisors in each of the subject jurisdictions were consulted to ensure that the transactions comported with local tax law and policy in a manner that enabled the company to minimize unintended consequences. Since economies of scale on fees and other costs came into play on every Swiss capital increase and share issuance, there was a significant interest in coordinating and grouping the various Target share contributions into a few "waves," so that each Swiss capital raise would be for several simultaneous contributions of Targets. We developed a short-form share contribution agreement template, lacking many of the representations, warranties and covenants that would ordinarily be in a similar document. Nevertheless, the disparities between the different country corporate statutes, regulatory burdens and speed of processing documents at their respective commercial registries and analogous bodies made coordination of the efforts of local counsel and comptrollers difficult but critical. Finally, a major consideration was coordinating Target countries' stamp duty relief application procedures, in certain jurisdictions available for inter-company group transfers. Depending on the size and number of transactions involved, stamp duty savings can be considerable, so once again, planning is essential. In some jurisdictions, the stamp duty relief application had to be made before the share contribution transaction

(Singapore); in some countries after the transaction (U.K., Ireland), with official approval never on a precise schedule, further complicating the coordination of share contribution transactions for purposes of simultaneous Swiss capital raises and issuances of Consideration Shares. In China, an application for "Special Tax Treatment," or "STT," drove the timing of the transaction because of the different government offices through which the paperwork had to flow.

The second step of the Target contributions was simpler, being Swiss-

Figure 3

Simplified Diagram of Luxembourg-Canada Transactions



Swiss transactions (Swiss Holdco as Contributor, Swiss Principal as Recipient). Swiss law itself does not require the issuance of Consideration Shares, so that in this stage of the TO Project, the issuance of Recipient Consideration Shares to Contributor, in this case those of Swiss Principal to Swiss Holdco, was mainly driven by the requirements of Target's jurisdiction, which in some cases required the issuance and in others, not.

One case in this part of the TO Project was illustrative. In the case of the Canadian CD, at this point held by Swiss Holdco, it was decided to convert the company, hitherto a corporation organized under the federal Canada Business Corporations Act, to a Nova Scotia unlimited liability company ("ULC"), because Nova Scotia ULCs, while holding out the possibility of unlimited liability in liquidation, as the name suggests, are eligible for check-the-box election as disregarded entities for U.S. tax purposes. However, there was concern at placing an unlimited liability entity directly below Swiss Principal and exposing Swiss Principal to contingent and future liabilities arising from the Canadian company. We developed a plan to use a Luxembourg company formed at an earlier point and earlier conception of the TO Project to hold the Canadian CD. In a staged mini-group set of transactions, the Luxembourg company ("Lux Holdco") was contributed from the parent Luxembourg company to Swiss Holdco. Then, Swiss Holdco contributed the Canadian subsidiary to Lux Holdco in exchange for Lux Holdco Consideration Shares. Finally,

Lux Holdco was contributed by Swiss Holdco to Swiss Principal and the Canadian company converted from a Canada corporation to a Nova Scotia ULC, resulting in a chain of ownership from Parent-Swiss Holdco-Swiss Principal-Lux Holdco-Canada ULC. The only other use of the ULC form, for similar reasons, was for the group's New Zealand subsidiary, which was held by the Australian subsidiary, which had been contributed by U.S. Foreign Holdco to Swiss Holdco.

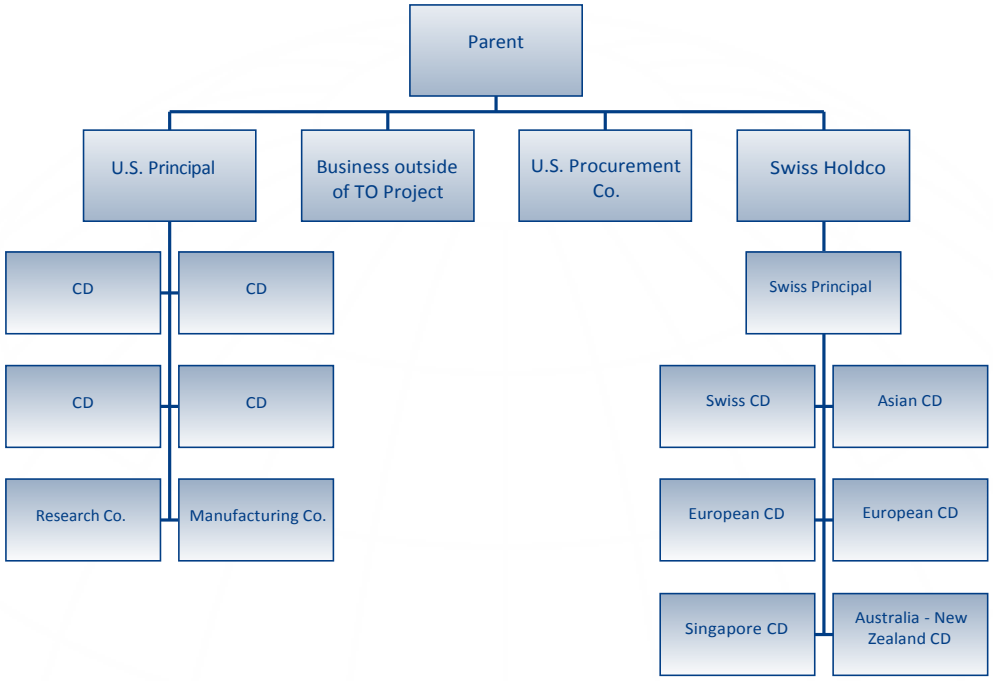
Finally, the CDs not already in LLC equivalent forms were converted to LLC equivalents in their local jurisdictions for U.S. "check-the-box" treatment as disregarded entities. Although the attributes of the LLC equivalents vary from jurisdiction to jurisdiction, and the conversion process itself varied from the simple to the byzantine, in each case it was ultimately possible to convert the CD to a local law form that would be a disregarded entity for U.S. tax purposes and would more readily suit the business purposes for which the entire project was undertaken. Again, it was necessary to consult local advisors to make sure that the selected approach was consistent with local tax law and policy, and that the correct procedure was followed to ensure that the process was a true conversion, with no cessation of the CD's existence. In several cases, it was necessary for the CD to capitalize a loan with another member of the corporate group prior to converting. In several transactions, the requirements of local law required that the CD, as converted to an LLC equivalent, maintain a second equity holder, making the goal of having each non-U.S. CD wholly-owned by Swiss Principal

impossible. In those cases, a minority equity position was given to another CD (interestingly, in no case did the two-equity holder requirement prevent Swiss Principal from being the indirect owner of the minority stake. In other cases, local law required a certain level of capitalization for the CD and Swiss Holdco capitalized the company to the extent necessary.

We encountered a particular level of difficulty with one of the group's South American subsidiaries. That South American jurisdiction requires registration by its commercial registrar of all non-domestic shareholders of domestic companies and requires two shareholders. Our plan required the registration of both Swiss Principal and the group's Swedish subsidiary. This took a great deal of time at the government registry level, and because the two shareholders could not vote on anything pertaining to the South American company until they were registered, it also delayed the conversion of the company to the local LLC equivalent.

Figure 4

Simplified Diagram of Corporate Structure at End of TO Project



At the end of TO Project, corporate structure is rationalized, with U.S.-facing CDs subsidiary to U.S Principal and non-U.S. facing CDs subsidiary to Swiss Principal.

Mopping Up Procedures

With the corporate restructuring largely complete, it remained to put in place several intercompany commercial agreements that would allow sharing, consignment and distribution of inventory, as well as the use of warehouse space and other assets among U.S. Principal, Swiss Principal and CDs in both the U.S. and non-U.S. markets. A feature of these commercial arrangements was to house all non-U.S. procured products in Swiss Principal, allowing conveyances by "flash title." The

main concern with these commercial arrangements was that they not do violence to the Swiss Principal model and not cause the CDs to be viewed as "permanent establishments" of the group for taxation purposes. These agreements therefore provided that Swiss Principal took title to procured goods and to company products to be sold into the non-U.S.-facing market, and that the CDs did not at any time have title, serving fundamentally a marketing and distribution function. Similar agreements were executed for U.S. Principal for the U.S.-facing market. Other features of the agreements existed because of the need to treat the intercompany agreements as arms' length transactions.

Conclusion

The buy/sell companies in multiple countries became CDs of the Swiss Principal. The CDs could sell the group's products in their own name, but on behalf of Swiss Principal and at Swiss Principal's risk. Title to the goods sold would pass directly from Swiss Principal to the third party customer without vesting in the CD in between. The Swiss Principal would centralize accounts receivable risk, currency risk, supply chain risk and inventory risk and is able to coordinate the procurement and pricing of its suppliers. In doing so, it could spread, amortize and reduce those risks among all the regions covered by the CDs. Swiss Principal could also harmonize pricing across the group's distribution zones, reducing transfer pricing issues and enabling the realization of supply chain and tax efficiencies. However, the CDs would remain the contractual counterparties to the group's customers, able to operate

locally, leverage customer contacts and local conditions and in general focus on their core competency, marketing and distribution. Also, the CDs would remain subject to most local regulatory constraints. U.S. Principal would function in the same way for the U.S.-facing market. By harmonizing its operational structure with its formal legal organization, the company group expected to achieve savings of millions of dollars per year, translatable to Parent's share price and easily justifying its investment in the TO Project. Any U.S. corporation with multinational operations and an unoptimized corporate structure that would benefit from reorganization of its operations along regional lines and responsibilities should consider whether a principal or other efficiency and profitability promoting restructuring might achieve similar benefits for it.

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