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Global Tax Alert

Report on recent US international tax developments - 6 December 2019

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The United States (US) Treasury on 2 December released final regulations (T.D. 9885) on the base erosion anti-abuse tax (BEAT) under Internal Revenue Code[1] Section 59A. The final regulations are generally consistent with the proposed regulations published on 21 December 2018, but with certain modifications. Treasury also issued proposed regulations (REG-112607-19) under Section 59A. Taxpayers may rely on the new proposed regulations for tax years beginning after 31 December 2017.

The final and new proposed regulations include rules that:

- Generally exclude from the base erosion payment definition amounts transferred to, or exchanged with, a foreign related party pursuant to a nonrecognition transaction under Sections 332, 351, 355, or 368 – a significant and taxpayer-favorable change from the 2018 proposed regulations (the exclusion would not apply to amounts treated as "other property" in the final regulations)
- Propose to allow a taxpayer to elect to forego a deduction so that it is not taken into account as a base erosion tax benefit, but only if the taxpayer waives the deduction for all US federal income tax purposes
- Clarify that a built-in loss recognized on a sale or transfer of property to a foreign related party is not in itself a deduction that causes the payment to be treated as a base erosion payment

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- Provide that Section 15 does not apply to blend the BEAT rates of 5% and 10% for the tax year of a fiscal-year taxpayer beginning in calendar year 2018
- Provide that Alternative Minimum Tax credits do not reduce adjusted regular tax liability for purposes of determining a taxpayer's base erosion minimum tax amount
- Clarify the scope and application of the Section 59A anti-abuse rules through additional examples and add a specific anti-abuse rule targeting transactions that increase the basis of property that a taxpayer acquires in a nonrecognition transaction

Also on 2 December, the Government published final regulations (T.D. 9882) on determining the foreign tax credit under the Internal Revenue Code. The final regulations are generally consistent with the proposed regulations published on 28 November 2018 but make certain important modifications and clarifications.

Notable provisions and changes in the final regulations include:

- Adding safe harbor methods for applying transition rules for the carryover of foreign taxes and loss accounts required as a result of the *Tax Cuts and Jobs Act's* (TCJA) addition of the foreign branch category
- Applying special rules for allocating income to the foreign branch category only to disregarded transfers of intellectual property occurring on or after 7 December 2018, and not if the intellectual property is repatriated to the US
- Consolidating to 10 the 16 previously-taxed earnings and profits groups introduced by Notice 2019-01
- Requiring an upper-tier controlled foreign corporation (CFC) to take the gross tested income (net of interest expense) of lower-tier CFCs into account for purposes of allocating and apportioning its interest expense under the modified gross income method

Treasury also proposed new regulations (REG-105495-19) that address the allocation and apportionment of expenses.

New Proposed Reg. Section 1.861-20 provides guidance on the allocation and apportionment of foreign taxes to separate Section 904(d) categories of income.

The new proposed regulations also address TCJA-related changes to Section 905(c) by re-proposing and modifying the prior 2007 proposed regulations; specifically those dealing with foreign tax redeterminations that affect deemed paid taxes and notification of those redeterminations. Of note, the new proposed regulations clarify that adjustments are also required to earnings and profits and inclusions for the year to which the taxes relate.

The Internal Revenue Service (IRS) on 6 December issued Notice 2019-65, announcing that Treasury and the IRS intend to amend the regulations under Section 987 to defer the applicability date of the final regulations under Section 987, as well as certain related final and temporary regulations, by one additional year.

Notice 2017-57, published on 16 October 2017, and Notice 2018-57, published on 25 June 2018, each delayed the applicability date of the final regulations, along with the related final and temporary regulations, by one year.

On 3 December, US Treasury Secretary Steven Mnuchin sent a letter to the Organisation for Economic Co-operation and Development (OECD) Secretary General José Ángel Gurría explaining that the US has "serious concerns" about aspects of the OECD project to address the tax challenges of digitalization. He suggested that the goals of Pillar 1 – which focus on an approach to the new nexus concept and an approach for new and revised profit allocation rules – could be "substantially achieved" by making it a safe-harbor regime.

The Treasury Secretary specifically pointed to concerns about the "potential mandatory departures from arm's-length transfer pricing and taxable nexus standards." The letter said the United States fully supports a "GILTI-like Pillar 2 solution."

The letter went on to say that the US looks forward to working with the OECD "along these lines," and that it is important for talks to reach agreement to prevent unilateral Digital Services Taxes, which the US opposes and which, according to Mnuchin, "threaten the longstanding multilateral consensus on international taxation."

The OECD Secretary General responded the next day, writing in a letter to Secretary Mnuchin that throughout the extensive consultation process, there has been no discussion that "Pillar 1 could be a safe-harbor regime."

The Office of the United States Trade Representative (USTR) on 2 December proposed additional duties of up to 100% on US$2.4 billion in French products, in response to France's enactment of a Digital Services Tax (DST) earlier this year. The USTR also issued a report opposing the French DST and said investigations regarding similar taxes in other nations are under consideration. The USTR's action came as a 90-day US-France agreement reached over the summer to forestall a trade war over the French DST expired.

The French Finance Minister said the European Union (EU) would retaliate if the US follows through with the proposed tariffs, and EU officials backed up that statement. At a media event at this week's NATO Summit, President Trump said the US has a "very unfair trade situation" with the EU and "the digital tax is the least of it," but that "I think we'll work something out."

Endnote

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

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