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EY Tax News Update: Global Edition

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Digital taxation

OECD issues consultation document on technical design aspects of Pillar Two

On 8 November 2019, the OECD released the highly-anticipated public consultation document on the Global Anti-Base Erosion (GloBE) proposal under Pillar Two of the ongoing project titled, "Addressing the Tax Challenges of the Digitalisation of the Economy" (the Consultation Document). The particular design proposals were prepared by the OECD Secretariat and do not represent the consensus view of the countries participating in the project as members of the Inclusive Framework.

The GloBe proposal

Pillar Two of the Workplan seeks to develop an integrated set of global minimum tax rules to ensure that the profits of internationally operating businesses are subject to at least a minimum rate of tax. The OECD has indicated that the level at which the minimum tax rate will be set is to be discussed by the participating jurisdictions once other key design elements of the proposal are fully developed.

The four components of the GloBE proposal set out in the Programme of Work include:

- a. An income inclusion rule that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate.
- b. An undertaxed payments rule that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at or above a minimum rate.
- c. A switch-over rule to be introduced into tax treaties that would permit a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to an effective rate below the minimum rate.
- d. A subject to tax rule that would complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and adjusting eligibility for a treaty.

The GloBE proposal would also incorporate an ordering rule to avoid the risk of double taxation.

The Consultation Document invites comments on all aspects of the Workplan on Pillar Two, but in particular requests input on the following three technical design aspects of the GloBE proposal:

- Tax base determination: considering the implications of using financial accounts as a possible simplification for determining the tax base and approaches to neutralizing differences between financial accounts and taxable income.
- Blending: considering the extent to which low-tax and high-tax income within the same entity or across different entities within the same group should be combined for purposes of determining the effective tax rate.
- Carve-outs and thresholds: considering possible approaches for restricting the application of the GloBE proposal.

The Consultation Document also includes an annex that sets out several simplified examples illustrating the approaches for addressing temporary differences in the measurement of tax and accounting income. The facts of the examples are based on the potential application of the income inclusion rule. However, the Consultation Document indicates that the examples are not intended to suggest that these approaches are any less feasible for addressing temporary differences on the applicability of other elements of the GloBE proposal.

As noted earlier, the Consultation Document does not represent the consensus views of the jurisdictions participating in the Inclusive Framework. However, the OECD Secretariat prepared the Consultation Document to focus on specific technical issues in respect of the GloBE proposal where input from stakeholders would be valuable in continuing the work on the project.

There are additional technical and design aspects of the GloBE proposal that depend on policy choices that will need to be agreed within the Inclusive Framework, including, for example, the minimum tax rate, the mechanics and operation of the undertaxed payment rule, and the nature and scope of the subject to tax rule.

As the Consultation Document expressly states, the proposals under Pillar Two represent a substantial change to the tax architecture and go well beyond digital businesses or digital business models. These proposals could lead to significant changes to the overall international tax rules under which multinational businesses operate.

It is important for businesses to follow these developments closely in the coming months as work continues on key technical, design, and policy aspects of the GloBE proposal. Businesses should also consider engaging with the OECD and policymakers at both the national and multilateral levels on the business implications of these proposals. Companies should also begin to evaluate the potential impact of these changes on their business models.

The OECD will hold a consultation meeting on 9 December 2019 to give stakeholders an opportunity to discuss their comments with the Inclusive Framework jurisdictions.

Treasury and IRS news

IRS issues final regulations on ownership attribution rules for CFC purposes

The IRS on 18 November 2019, issued final regulations ([T.D. 9883](#)) on the attribution of ownership of stock or other interests for purposes of determining whether a person is a related person with respect to a controlled foreign corporation (CFC) under Section 954(d)(3). The final regulations also provide rules for determining whether a CFC is considered to derive rents in the active conduct of a trade or business for purposes of computing foreign personal holding company income.

The final regulations adopt proposed regulations ([REG-125135-15](#)) issued in May 2019 without change. The final regulations are effective 19 November 2019.

The final regulations have important consequences for computing subpart F income and global intangible low-taxed income inclusions (as well as for other provisions). They could cause amounts that a taxpayer had not treated as subpart F income to qualify as subpart F income (and vice versa). The regulations generally finalize two major changes.

First, they modify how certain constructive ownership rules under Section 318(a) apply for purposes of characterizing a person as a “related person” with respect to a CFC under Section 954(d)(3). These modifications apply to an amount that a CFC receives or accrues on or after 17 May 2019, if the receipt or accrual is “accelerated” with a principal purpose of avoiding the modifications.

Second, the regulations modify the manner in which royalties paid or accrued by a CFC are treated for purposes of applying the “safe harbor” threshold of the “active marketing exception” to “foreign personal holding company income” (a component of subpart F income) for certain rents earned by the CFC.

IRS announces campaign to audit Section 965 transition tax compliance

The IRS Large Business and International (LB&I) Division opened a new campaign to examine companies’ compliance with the Section 965 transition tax enacted by the *Tax Cuts and Jobs Act* (TCJA); the IRS made the announcement on its website on 4 November 2019.

In 2018, the IRS released [FAQs](#) with guidance on reporting, filing, and payment requirements under Section 965. Final Section 965 regulations were released in January 2019. The rules were retroactive and applied to a foreign corporation’s last tax year that began before 1 January 2018, and to a US shareholder’s tax year in which or with which the foreign corporation’s year ends.

LB&I campaign

The IRS will conduct examinations of the reported Section 965 liability on selected tax returns, in most cases looking at the returns for both 2017 and 2018. In addition, those staffing the campaign will provide technical assistance to teams examining Section 965 issues, “with a focus on identifying and addressing taxpayer populations with potential material compliance risk.” LB&I will also risk-assess returns selected as part of the campaign for other material issues, especially those “related to TCJA planning.”

The announcement of the Section 965 campaign aligns with the IRS’s heightened focus on TCJA compliance. LB&I has publicly stated that it intends to examine tax planning around the TCJA, including the components underlying the calculation of a taxpayer’s Section 965 liability.

IRS representatives have indicated that the IRS will be looking closely at taxpayers’ earnings and profits calculations, the classification of assets as cash versus non-cash, and how taxpayers determined their foreign tax credits, among other issues. Exam personnel will also look at how Section 965 intersects with other TCJA provisions, such

OMB announces new IRS final reg project on rules for domestic shareholders' accounting method changes for foreign corporations

The Office of Management and Budget's Office of Information and Regulatory Affairs on 20 November 2019, released its [fall 2019 unified agenda](#). One new project that was not included in the IRS's [2019/2020 priority guidance plan](#) concerns final regulations that would clarify the application of Reg. Section 1.964-1 relating to the rules for controlling domestic shareholders to adopt or change a method of accounting on behalf of foreign corporations. Proposed regulations date from November 2011.

as the Base Erosion and Anti-abuse Tax, Global Intangible Low-taxed Income and Foreign Derived Intangible Income. This is particularly significant given the extended six-year statute of limitations on assessments that applies to Section 965 liabilities.

Treasury officials offer TCJA international guidance timeline

A senior US Treasury official in mid-November provided a rundown of coming *Tax Cuts and Jobs Act* (TCJA) international guidance. David Kautter, Treasury Assistant Secretary for Tax Policy, told a Washington audience that both final foreign tax credit regulations and final and proposed Base Erosion and Anti-abuse Tax (BEAT) regulations would be released shortly (both packages of final and proposed regulations were issued the week of 2 December).

The official also said that final and proposed regulations under Section 163(j) may be released by the end of December and counted over 550 pages.

Other TCJA international tax guidance expected by year end or in January 2020 includes final and proposed regulations under Section 267A on related party amounts paid or accrued in hybrid transactions or involving hybrid entities, and proposed regulations on the new inventory sourcing rule under Section 863(b).

Another senior Treasury official in mid-November was quoted as saying that the final regulations on the Foreign Derived Intangible Income deduction, the new Global Intangible Low Tax Income high-tax exclusion and the Section 250 participation exemption will be issued in the first half of 2020.

Transfer pricing news

Ninth Circuit denies en banc rehearing in *Altera*

On 12 November 2019, the Ninth Circuit Court of Appeals [denied](#) a request by the taxpayer in *Altera v Commissioner* for a rehearing before the full court on the issue of whether participants in a cost-sharing arrangement (CSA) must share stock-based compensation costs (SBC costs). A Ninth Circuit panel previously upheld 2003 IRS regulations requiring CSA participants to share SBC costs.

The taxpayer has 90 days from 12 November 2019 to apply for certiorari to the US Supreme Court.

US Tax Court rules no Section 6662 penalties after IRS abused discretion in canceling APAs

On 28 October 2019, the US Tax Court determined in [Eaton Corp. & Subs v. Commissioner](#), (*Eaton III*) that a corporation is not liable for penalties under Section 6662 for income tax adjustments made under court rules as part of a 2017 decision (*Eaton II*) in which the Court held that the IRS abused its discretion in canceling two advance pricing agreements (APAs). In this latest decision, which supplements the 2017 decision, the Court concluded that the penalties do not apply because the adjustments in the earlier decision were not made under Section 482. This is the third in a series of related *Eaton Corporation* cases dating back to 2013.

This series of cases has limited applicability to other taxpayers. The IRS has rarely attempted to cancel an APA.

US government aware transfer pricing may be used to reduce TCJA tax liability

An IRS official in early November warned taxpayers that the US government is aware that transfer pricing could be used to reduce Base Erosion and Anti-abuse Tax (BEAT) and other *Tax Cuts and Jobs Act* (TCJA) tax liability.

While taxpayers are currently reviewing their transfer pricing policies in light of the TCJA and are entitled to pick a price within a range of acceptable arm's-length prices, the official was quoted as saying the IRS will target inappropriate prices that are chosen to avoid BEAT. "A taxpayer who attempts to avoid BEAT by using non-arm's-length transfer pricing may be subject to a transfer pricing adjustment that will flow through and result in a BEAT adjustment," the official said.

Cyprus announces coming bilateral CbCR Competent Authority Agreement with United States

The Cypriot Tax Department on 30 October 2019, announced that a competent authority agreement for the exchange of country-by-country (CbC) reports between Cyprus and the US is expected to be finalized soon and effective for Reporting Fiscal Years (RFYs) starting on or after 1 January 2019.

As a consequence, the secondary filing mechanism for a Cypriot Constituent Entity (CE) of a multinational entity group with a US tax resident Ultimate Parent Entity (UPE) is triggered for RFYs starting on or after 1 January 2018 and before 2019.

Accordingly, a Cypriot CE whose UPE is a tax resident in the US will have an obligation to proceed with the local filing of the CbC report in Cyprus for its RFY ending on 31 December 2018, even if a CbC report has or will be submitted in the US.

OECD news

OECD holds public consultation on Pillar One of BEPS 2.0

The OECD held a public consultation in Paris on 21- 22 November on the proposal from the OECD Secretariat for a “unified approach” under Pillar One of the ongoing project titled “Addressing the Tax Challenges of the Digitalisation of the Economy.” The OECD released the Pillar One consultation document on 9 October 2019. Regarding the public consultation meetings, the tax press reported that “several commentators voiced concerns about the lack of clarity of some of the concepts introduced under Pillar One at this stage of the work.”

Separate from the public consultation, an OECD official confirmed that digital taxation will be addressed through a multilateral solution agreed to through the OECD framework by the end of 2020. The official was quoted as saying that unilaterally-imposed digital services taxes are incompatible with a BEPS 2.0 Pillar solution. He indicated that a multilateral, consensus-based solution agreed to by the Inclusive Framework is the only way to address the issue.

One key issue to be resolved will be some form of dispute resolution, according to another OECD official. The official was quoted as saying that while “some countries will

EY submits comment letter on OECD Pillar One

EY on 12 November 2019, submitted a [comment letter](#) to the OECD on the [public consultation document](#), *Secretariat Proposal for a “Unified Approach” Under Pillar One*.

The EY submission provides a comprehensive review of the strategic issues involving Pillar 1, as well as key implementation issues that must be resolved.

not agree to binding arbitration” - an idea that the US government has strongly supported - the OECD is exploring other ways to getting to binding dispute resolution without arbitration.

OECD releases database to provide insights on global profiles of individual multinational enterprises

The OECD has developed a new database - [the Analytical Database on Individual Multinationals and Affiliates \(ADIMA\)](#) - which provides information on individual multinational enterprises (MNEs) and their global presence. The ADIMA database contains public information on the physical and digital locations of the MNE, detailed financial and quantitative data (including revenue, profit, income tax and number of employees), and an indication of “events” such as large company restructurings.

The database currently contains 100 of the largest publicly traded, non-state-owned MNEs (by sales) in the world, with both more companies and data points expected to be added in future releases. The MNEs in aggregate generated nearly US\$10 trillion in revenues (almost 20% of the global gross domestic product), earned \$730 billion in profits and paid \$185 billion in taxes.

The purpose of the database is to provide a “whole view” of MNEs, including where they are located, how they operate and where they pay taxes. The OECD used several open big data sources to collect public information on individual MNEs and their global footprint. The creation of the ADIMA, with its detailed and individualized data, is an important development in global transparency.

Companies should be aware of the information about them that is included in the database and how this information aligns with the information that is required to be provided to the tax authorities (e.g., transfer pricing documentation and country-by-country reporting).

OECD releases additional guidance on spontaneous exchange of information by no or only nominal tax jurisdictions

On 31 October 2019, the OECD released new [guidance](#) titled “Substantial Activities in No or Only Nominal Tax Jurisdictions: Guidance for the Spontaneous Exchange of Information.”

The guidance addresses the practical modalities regarding the exchange of information requirements of the “substantial activities requirement” for “no or only nominal tax” jurisdictions (the [Standard](#)) that was agreed to by the Inclusive Framework on BEPS in 2018. It provides guidance on the timelines for the exchanges, the international legal framework under which they may occur and clarifications on the key definitions, to ensure that spontaneous exchanges take place in a coordinated and efficient manner.

The guidance also contains a standardized IT format for the spontaneous exchanges, the No or only nominal Tax Jurisdictions (NTJ) XML Schema and the related user guide.

It is expected that exchanges pursuant to the standard will commence in 2020.

OECD releases additional guidance on CbC Reporting, summary of common errors made by MNE groups in preparing reports

On 5 November 2019, the OECD released additional guidance to give greater certainty to tax administrations and multinational enterprise (MNE) groups on the implementation and operation of BEPS Action 13 Country-by-Country (CbC) Reporting (CbCR).

The existing [guidance](#) on the implementation of CbCR consequently has been updated to include questions and answers on, among other topics, treatment of dividends, the deemed listing provision, accounting periods other than 12 months, the requirements for and operation of local filing, the use of rounded amounts and the information that must be provided with respect to the sources of data used.

The OECD also published a summary of common errors made by MNE groups in preparing CbC reports (the [Summary](#)). The release of this Summary aims at helping MNE groups to avoid these errors and tax administrations in detecting them when they occur.

The guidance marks the ninth release by the OECD regarding practical questions that have arisen concerning the implementation and operation of CbCR. The guidance will continue to be updated with any further guidance that may be agreed by the inclusive Framework on BEPS.

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