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Global Tax Alert

Report on recent US international tax developments – 31 January 2020

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There has been some public rumination as to what the United States (US) Treasury Secretary Steven Mnuchin meant last December when he wrote to the Organisation for Economic Co-operation and Development (OECD) General Secretary that the goals of Pillar One – 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. There has been concern by the OECD and among some European governments that the US favored making the Pillar One proposals into an elective or optional regime.

A senior Treasury official was recently quoted as saying that the Treasury Secretary believes it was a mischaracterization to say that the US Government favors making the Pillar One proposals optional; rather, that they should be viewed as a safe harbor. The official added there has not been a change in the US position on this matter. According to the official, the Treasury Secretary has political concerns that Congress would not approve making the Pillar One proposals mandatory.

Also related to Pillar One, the OECD's Inclusive Framework (IF) on BEPS, a group of 137 jurisdictions, met in Paris on 29-30 January to discuss the Pillar One and Two proposals. In a statement following the meeting, IF members affirmed their "commitment to reach an agreement on a consensus-based solution by the end of 2020." During the meeting, the IF also agreed to "an outline of the architecture of a Unified Approach on Pillar One as the basis for negotiations and welcomed the progress made on Pillar Two."

Building a better working world

The Internal Revenue Service (IRS) recently released a technical advice memorandum (TAM) 202004010, ruling that professional and administrative fees paid by a Target corporation in connection with the acquisition of its stock by a Taxpayer did not create a separate and distinct intangible asset, and were not deductible as a loss under Internal Revenue Code[1] Section 165 by Target upon the subsequent sale of Target's stock by the Taxpayer. The conclusions reached in the present TAM are consistent with prior IRS guidance on a similar issue in TAM 200502039.

The IRS's approach in the TAMs is also consistent with the language in the 1992 US Supreme Court decision in *INDOPCO, Inc. v. Commissioner*. In that case, the Court held that professional expenses incurred by a target corporation in the course of a friendly takeover must be capitalized, in part, because of the synergistic benefits expected to be generated in the future by combining the target's and acquirer's businesses.

In the absence of guidance on the treatment of capitalized transaction costs, the IRS is likely to consider that a target's capitalized costs are not recoverable until the trade or business ceases or the target otherwise dissolves. Taxpayers are encouraged to seek advice or analyze carefully to see if portions of the costs may be recovered at an earlier date, such as when the target operates several lines of business and disposes of one of the lines of business.

United Kingdom (UK) Prime Minister Boris Johnson on 24 January signed the Withdrawal Agreement covering the withdrawal of the UK from the European Union (EU). The European Parliament ratified the agreement on 29 January, taking the final legal step for the UK to leave the EU at 11 pm on 31 January 2020. The UK will then enter a transition or implementation period lasting until 31 December 2020, during which it will need to comply with EU rules and laws (but will no longer be able to influence those laws). In regards to taxation, this means that EU tax directives, which apply between Member States, should continue to apply to the UK during this period, as the UK should still be treated as a Member State.

Following the transition period, unless a specific agreement is reached with the EU (or via unilateral action by Member States), the UK will no longer be able to benefit from EU directives in respect of payments made from Member States. Instead, the UK (and taxpayers) will need to rely on the UK's double taxation agreements (DTAs) with individual Member States to limit the domestic withholding taxes that can be levied by those Member States. UK tax authorities (HMRC) are considering the need to negotiate new arrangements for those cases (such as Italy) where the current DTAs do not provide for a complete exemption from withholding taxes.

In respect of interest and royalty payments made from the UK, HMRC has issued guidance which confirms its view that, although the EU directives will not be available following the transition, relief from UK withholding tax on interest and royalties may continue to be available if the conditions are met, because of how the directive was transposed into UK domestic law. As the UK does not apply withholding tax on dividends, there was no need for specific UK legislation to implement the EU Parent-Subsidiary Directive. See EY Global Tax Alert, *UK: Brexit Withdrawal Agreement, future trading relationship, immigration and VAT implications*, dated 30 January 2020 for details regarding the tax and other major issues, including trade, immigration, and value-added tax.

The EU will also send a diplomatic note to more than 160 counties with whom the EU has international agreements, effectively asking them to treat the UK as a Member State until the end of the transition period. There is no obligation on non-EU Member States to do so, however.

Brexit will likely be a major disrupter for many multinationals and will require significant consideration.

Endnote

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

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