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EY Tax News Update: Global Edition

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Treasury and IRS news

US officials offer new insights in coming international guidance

US government officials in January 2020 offered some insights into upcoming international tax guidance.

In regard to the Section 245A dividends received deduction (DRD), an IRS official recently was quoted as saying that final Section 245A regulations — that follow temporary regulations issued in June 2019 (TD 9865) — would be issued before general proposed regulations on the DRD. A Treasury official also said the government is considering making changes to the temporary DRD regulations in respect of the "extraordinary reduction closing-the-books election," and that those regulations could be finalized by early spring.

The IRS official declined to take a position on whether Treasury and the IRS should adopt an expansive approach with respect to DRD eligibility for dividends from lower-tier specified foreign corporations, saying the government is still considering whether to extend the deduction to the controlled foreign corporation level, as opposed to it being only applicable to domestic corporations. He noted that determining eligibility in this regard could present a problem.

Addressing another major set of pending guidance, another Treasury official was quoted as saying that final Section 163(j) business interest deduction limitation regulations will be released with newly proposed regulations that will address issues not covered by the coming final regulations.

The proposed regulations under Section 163(j) have not been sent to the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs for review, which may delay the release of the final interest limitation regulations (which have been at the OMB since mid-December 2019).

In addition, Treasury and the IRS reportedly may be scaling back the broad definition of interest in the 2018 proposed Section 163(j) regulations, according to an IRS official earlier in the month. While the official defended the Government's authority to provide an expansive definition of interest, she was also quoted as saying the government is considering trimming the list of items not normally considered interest.

Section 163(j), as amended by the *Tax Cuts and Jobs Act*, limits the deduction for business interest expense for tax years beginning after 31 December 2017. The proposed regulations, issued on 26 November 2018, include in the definition of interest many items that are not treated as interest under general Federal income tax principles, the Code or regulations, but that the IRS and Treasury viewed as "closely related" to interest and that "affect the economic yield or cost of funds of a transaction involving interest."

In light of the pending phaseout of the London interbank offered rate and variant interest rates, the IRS in October 2019 issued proposed regulations (REG-118784-18) that address the tax issues resulting from the transition to the use of reference interest rates other than interbank offered rates (IBORs) in debt instruments and other contracts. The transition from IBOR may impact debt instruments as well as many non-debt instruments that reference IBOR.

An IRS official in January said that the IRS is considering amending the fair market value requirement in those proposed regulations.

US, France retreat on DST dispute

The United States and France in January 2020 reportedly reached agreement to defuse the ongoing dispute over France's enactment of a Digital Services Tax (DST) last July, and thereby possibly averting a trade war. According to press reports, France will suspend collection of the 3% DST and, in turn, the US will not impose retaliatory tariffs of up to 100% on approximately US$2.4 billion of French goods.

No action by either side will be taken through the end of 2020 in the hopes of reaching a multilateral digital tax agreement.

In the meantime, US Treasury Secretary Steven Mnuchin was quoted as saying that the United Kingdom and Italy could face retaliatory US tariffs if they continue with their own, respective, digital services taxes. The US Government's position is that unilateral digital services taxes discriminate against US companies.

IRS will consider cryptocurrency PLRs

An IRS official in January was quoted as saying the IRS is willing to entertain issuing private letter rulings (PLRs) in the cryptocurrency space to address issues not covered in cryptocurrency guidance issued in October 2019.

The IRS issued Revenue Ruling 2019-24 and frequently asked questions (FAQs) that expanded on guidance issued in Notice 2014-21. The official said that taxpayers interested in entering into a letter ruling should contact the IRS to request a pre-submission conference. Taxpayers may also send cryptocurrency questions to the IRS using a link in the cryptocurrency FAQs posted on the IRS website.

IRS final regulations on US partner contributions to partnerships with related foreign partners have few changes from prior temporary regulations

The IRS has finalized regulations that deny nonrecognition treatment to contributions of appreciated property by US persons to certain partnerships with related foreign partners. More specifically, the IRS on 17 January 2020 issued final regulations (TD 9891) under Section 721(c), which provide that if a US person transfers certain appreciated property to a partnership with a related direct or indirect foreign partner, the general nonrecognition rule of Section 721(a) does not apply unless the partnership adopts the remedial allocation method and meets certain other requirements.

The final regulations further provide that a segment of a tax year resulting from a change in the partners' interests in the partnership, accounted for under the interim closing method in the Section 706 regulations, is treated as a "taxable year" for purposes of applying the consistent allocation method.

The final Section 721(c) regulations, which replace temporary regulations (TD 9814) issued in January 2017, do not materially change the rules in the temporary Section 721(c) regulations. The final rules cause gain recognition with respect to certain property contributed to partnerships. Gain recognition can occur either at the time of contribution or upon later, and perhaps unforeseen, events. The regulations also create significant complexity and administrative burden, and limit flexibility to conduct transactions (including distributing property from a partnership) in the future.

The final regulations are effective 17 January 2020 (although they generally apply to contributions occurring on or after 6 August 2015).

Final FATCA and chapter 3 regulations issued

Treasury and the IRS have issued final regulations (TD 9890) under the *Foreign Account Tax Compliance Act* (FATCA) and chapter 3 of the Internal Revenue Code, finalizing some of the provisions included in the proposed regulations published in December 2018.

FATCA generally requires US and non-US withholding agents (including foreign financial institutions (FFIs)) to identify who their payees are and the FATCA status of those payees. FATCA is found in chapter 4 of the IRC (Sections 1471 - 1474).

Chapter 3 of the IRC (Sections 1441 - 1446) generally requires withholding at a rate of 30% on US-source fixed or determinable, annual or periodic income paid to nonresident aliens.

The final regulations address:

- Collection of a Foreign Taxpayer Identification Number (TIN) and date of birth (DOB) on a beneficial owner withholding certificate
- Nonqualified intermediary withholding statements
- Electronic signatures for chapter 3 and 4 purposes
- Withholding certificates and withholding statements furnished through a third-party repository for purposes of chapters 3 and 4
- Limitations on benefits for treaty claims on withholding certificates and treaty statements provided with documentary evidence
- Hold-mail instructions

Treasury and the IRS intend to finalize the remaining provisions in the 2018 proposed regulations "at a future date."

The final regulations are very consistent with the proposed regulations and other guidance previously published by the US Government.

IRS will consider certain requests for double taxation relief due to Section 965 repatriation

The IRS announced in a 17 January 2020 press release (IR-2020-16) that in certain circumstances the agency might "provide relief from double taxation resulting from application of the repatriation tax" under Section 965, as amended by the *Tax Cuts and Jobs Act* (TCJA). This double taxation can occur, for example, when the same earnings and profits (E&P) of a foreign corporation are taxed both as dividends and as deferred foreign income under Section 965. If a corporation paid an unusual dividend for business reasons, rather than to avoid the TCJA, the IRS could conclude that it is "appropriate to provide relief from double taxation," as long as there is no significant reduction in the resulting tax from applying foreign tax credits.

An IRS official later commented on the proposed relief, saying the announcement is an example of the Service willing to consider — and possibly offer — relief for "one-off, taxpayer-specific issues," and that the Service is interested in hearing about unintended consequences from the application of IRS guidance.

While the IRS official said the announcement was "intentionally cryptic," a Treasury official later elaborated that the repatriation relief is meant to be seen as offered on a case-by-case basis and not based on a certain set of guidelines that taxpayers must meet. The IRS will listen to the taxpayer's particular circumstances and determine whether the taxpayer merits double taxation relief, he said.

By acknowledging the possibility of double taxation and providing for potential relief, this announcement represents a significant departure from the final regulations under Section 965. Companies that encountered double taxation as result of E&P being taxed under Section 965 and as dividends or Section 956 inclusions should consider seeking relief.

IRS rules target's capitalized transaction costs do not create a separate and distinct intangible asset

The IRS in late January 2020 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 Section 165 by the Target upon the subsequent sale of the 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.

OECD news

OECD announces renewed IF commitment for 2020 consensus on new international tax rules under BEPS 2.0

On 31 January 2020, the OECD released a Statement by the Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalization of the Economy (the Statement). According to the Statement, members of the Inclusive Framework – which currently includes 137 jurisdictions – have affirmed their commitment to reach an agreement on new international tax rules by the end of 2020. The Statement and its more detailed annexes reflect the outcome of the plenary meeting of the Inclusive Framework on 29-30 January.

The Statement indicates that it is intended that the Inclusive Framework at its next meeting in early July 2020 will reach agreement on the key policy features of the solution that would form the basis for a political agreement.

Attached to the Statement are more detailed documents, including an outline of the architecture and a revised workplan for Pillar One, relating to revised nexus and profit allocation rules, and a progress update on Pillar Two, relating to new global minimum tax rules. With respect to Pillar One, the Inclusive Framework has endorsed a unified approach as the basis for the ongoing negotiation of a consensus-based solution. With respect to Pillar Two, the Inclusive Framework has welcomed the progress that has been achieved to date.

OECD releases additional guidance on CbCR and summary of related notification requirements

The OECD has released additional guidance which is designed to give greater certainty to tax administrations and multinational enterprise (MNE) groups regarding the implementation and operation of BEPS Action 13 Country-by-Country (CbC) Reporting (CbCR). The new CbCR Guidance makes it clear that, under the BEPS Action 13 minimum standard, the automatic exchange of CbC reports filed under local filing rules is not intended.

The OECD also posted on its website a Summary of CbCR notification requirements in Inclusive Framework member jurisdictions, to help MNE groups comply with the notification requirements in those jurisdictions where the MNE has constituent entities.

The Guidance marks the OECD's 10th release of practical questions and responses that have arisen concerning the implementation and operation of CbCR. The Guidance will continue to be updated with any further output that may be agreed by the inclusive Framework on BEPS.

OECD releases third peer review report on Action 5 on the exchange of tax rulings

The OECD released the third annual peer review report relating to the compliance by members of the Inclusive Framework (IF) on BEPS with the minimum standard on Action 5 for the compulsory spontaneous exchange of certain tax rulings (the transparency framework).

UK leaves EU on 31 January 2020, begins transition period

UK Prime Minister Boris Johnson on 24 January 2020 signed the Withdrawal Agreement covering the withdrawal of the UK from the 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 regard 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 that 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.

The EU will also send a diplomatic note to more than 160 countries 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.

The report covers 112 of the 137 current BEPS IF jurisdictions, including all IF members that joined prior to 30 June 2018 and Jurisdictions of Relevance identified by the IF prior to 30 June 2018. The report assesses the 2018 calendar-year period and contains 52 jurisdiction-specific recommendations. It indicates that by 31 December 2018 more than 18,000 tax rulings in scope of the transparency framework had been issued by the jurisdictions under review, and around 30,000 exchanges of information had taken place.

The annual peer review report is a significant step in the OECD's efforts for more transparency and information exchange in the tax area. Member countries not only have to adapt their laws to be able to implement the transparency framework, but also adapt their tax administration systems to be able to process and report on information exchange.

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