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Legislation

President Trump signs interim coronavirus relief measure; attention turns to COVID-19 bill #4

President Trump on 24 April 2020 signed into law the *Paycheck Protection Program and Health Care Enhancement Act* (H.R. 266), a $484 billion interim coronavirus relief measure. The Senate and House passed the bill on 21 April, and 23 April, respectively. The legislation will provide $310 billion for the Small Business Administration's now-exhausted Paycheck Protection Program (PPP), $60 billion for disaster loans through the Economic Injury Disaster Loan program, and an additional $100 billion for the Department of Health and Human Services, which includes $75 billion for health care provider relief and $25 billion for coronavirus testing.

Legislative attention will now turn to a fourth COVID-19 bill, which may rival the CARES Act ($2 trillion) in scope. The US Senate will reconvene on 4 May with the House planning to return to session the week of 11 May, leaving the timing of a fourth major congressional bill to respond to the coronavirus uncertain. Congressional Republicans and Democrats meanwhile are drawing lines on what must – or will not – be included in the next COVID-19 bill, which could top $2 trillion or more.

The full House Ways and Means Committee and Treasury Secretary Steven Mnuchin held a phone meeting on 29 April during which they discussed a potential tax package for the next CARES 2/COVID 4 bill that could take shape in the coming weeks. Committee Chairman Richard Neal (D-MA) said Democrats' concerns include: "extremely small businesses' access to Paycheck Protection Program money; the quick deadline for certain economic impact payment recipients with dependents to provide their updated information to the IRS; and the need for cities and states to receive federal funds and flexibility with that assistance." Chairman Neal also reportedly urged Secretary Mnuchin to expand the Employee Retention Credit amid questions about how the benefit will apply.

Senate Majority Leader Mitch McConnell (R-KY) continues to be wary of what he views as unfettered COVID-19 stimulus funding, although conceding there will be a state and local component in the next coronavirus bill. The Majority Leader is generally concerned that Congress will act too fast and spend too broadly, thereby unnecessarily adding to the deficit.

IRS news

IRS issues final and proposed regulations on hybrid mismatches, DCLs and conduit financing; more certainty but some surprises

Treasury and the IRS on 7 April issued final regulations (TD 9896) implementing hybrid mismatch rules under Sections 267A and 245A(e) and rules for dual consolidated losses (DCLs) and entity classifications (the "Final Regulations"). Sections 267A and 245A(e) were enacted under the *Tax Cuts and Jobs Act* (TCJA) and are aimed at certain hybrid arrangements, with Section 267A denying deductions for certain hybrid arrangements and Section 245A(e) denying a dividends-received deduction for certain hybrid dividends.

In accompanying proposed regulations (REG-106013-19), the IRS and the Treasury provide guidance on hybrid deduction accounts (HDAs) under Section 245A(e), conduit-financing rules involving equity interests, and the treatment of certain payments under the Global Intangible Low-Taxed Income (GILTI) provisions (the Proposed Regulations).

The Final Regulations generally adopt with some changes the proposed regulations under Sections 267A and 245A(e), and the DCL rules issued in December 2018 (the 2018 Proposed Regulations).

The Final Regulations under Section 267 are generally effective for tax years ending on or after 20 December 2018. The Final Regulations under Section 245A(e) apply to distributions made after 31 December 2017, provided those distributions occur during tax years ending on or after 20 December 2018. For both Sections 267A and 245A(e), taxpayers may either apply the Final Regulations or the 2018 Proposed Regulations to earlier periods, but must apply either set of regulations in their entirety. The Final Regulations under both Sections have special effective dates for certain rules.

The Proposed Regulations would expand the conduit financing regulations under Reg. Section 1.881-3 to treat certain instruments characterized as equity for US tax purposes, but as debt for foreign law purposes, as a financing transaction that can result in a conduit financing arrangement. The Proposed Regulations would apply to payments made on or after the date that final regulations are published.

The Section 267A Final Regulations provide some much-needed clarity, especially on what constitutes a hybrid deduction for purposes of the imported mismatch rules and what constitutes interest for purposes of Section 267A. Additionally, the rules narrow the definition of interest, which may indicate the direction of the yet-to-be published final Section 163(j) regulations.

While the inclusion of interest free loans in the Section 267A Final Regulations may not come as a surprise to some taxpayers, the effective date of these rules might, as they apply for tax years beginning on or after 20 December 2018. Accordingly, taxpayers should review their capital structures to determine whether certain deductions are disallowed under this rule. The rules requiring GILTI inclusions (which are not disqualified hybrid amounts under Section 267A) to be reduced to take into account the Section 250(a)(1)(B) deduction will require taxpayers to more carefully consider the impact of Section 267A on payments to controlled foreign corporations.

Regarding Section 245A(e), the Final Regulations provide a mixed bag for taxpayers. On the one hand, the changes to the rules for HDAs, including the anti-duplication rule and the delayed effective dates for certain transactions, will be welcome. Additionally, the rules in the Proposed Regulations reducing the HDAs for subpart F income and GILTI provide some needed relief. On the other hand, Treasury rejected most comments requesting relief from some provisions of regulations that were not contemplated by the statute and the anti-avoidance rule remains quite vague.

The New Proposed Regulations under the conduit rules may take some taxpayers by surprise. By expanding the conduit financing rules to capture certain hybrid equity arrangements, the rules could have broad implications. Moreover, considering that these rules apply to payments made on or after the date those regulations are finalized, taxpayers should be currently reviewing their capital structures to determine if they could be affected by these new rules.

New anti-abuse rule targeting certain 'GILTI gap period' transactions included in proposed regulations on hybrid mismatch, dual consolidated loss, conduit financing and GILTI rules

The proposed regulations (REG-106013-19) released 7 April 2020 under Section 951A include a new rule that would effectively deny deductions for payments made directly or indirectly by a controlled foreign corporation (CFC) during the period from 1 January 2018 through the effective date of the Global Intangible Low-taxed Income (GILTI) provisions for the recipient CFC (the GILTI "disqualified period"). The proposed rule is intended to apply if (1) a payment is made during the disqualified period that would have given rise to tested income in the hands of the recipient CFC if the GILTI provisions had been effective for the recipient CFC, and (2) a deduction is taken in a later period when economic performance with respect to the earlier payment occurs.

The proposed regulations would apply to tax years of foreign corporations ending on or after the date of filing in the Federal Register and to US shareholders' tax years in which or with which such years' end.

Taxpayers need to consider international tax implications of making certain NOL elections under Revenue Procedure 2020-24

In Revenue Procedure 2020-24 (issued 9 April 2020), the Treasury and the IRS established the timing and methods for making certain elections related to the carryback of net operating losses (NOLs) under Section 172, which were enacted under the *Coronavirus Aid, Relief and Economic Security (CARES) Act*. Revenue Procedure 2020-24 addresses three Section 965 issues that are relevant to the carryback of NOLs.

First, it provides that the election to skip a year in the carryback period applies only to a tax year in which the taxpayer had an actual inclusion by reason of Section 965(a). As a result, a taxpayer that did not have an actual Section 965(a) inclusion (because its pro rata share of E&P deficits exceeded its pro rata share of the positive E&P of its deferred foreign-income corporations) may not elect to skip tax years in its carryback period.

Second, Revenue Procedure 2020-24 states that a deemed 965(n) election applies only for purposes of carrying back an NOL to a Section 965 inclusion year. Thus, it is the position of Treasury and the IRS that, if a taxpayer did not make an actual Section 965(n) election (or revoke a Section 965(n) election), the deemed Section 965(n) election does not prevent other current NOLs, or NOLs carried forward to the Section 965 inclusion year, from reducing the taxpayer's Section 965 liability. Under this position, the deemed Section 965(n) election will not release a current-year NOL or NOL carryforward that the taxpayer otherwise used to reduce its Section 965 inclusion.

Finally, Revenue Procedure 2020-24 states that an election to skip a Section 965 inclusion year applies to all Section 965 inclusion years excluded from the carryback period and is not revocable.

Revenue Procedure 2020-24 establishes the timing and manner for electing to skip Section 965 inclusion years. For NOLs arising in a tax year beginning in 2018 or 2019, the election must be made by the due date, with extensions, of the tax return for the first tax year ending after 27 March 2020. The election for NOLs arising in a tax year beginning after 31 December 2019, and before 1 January 2021, must be made by the due date, with extensions, of the tax return for the tax year in which the NOL arises.

The election to skip Section 965 inclusion years is made by attaching a statement to the earliest filed, after 9 April 2020, of: (1) the tax return the for tax year in which the NOL arises, (2) the claim for a tentative carryback adjustment on Form 1045 or Form 1139 to a tax year in the carryback period, or (3) the amended tax return applying the NOL to the earliest carryback year that is not a transition year.

While many taxpayers will want to quickly file either a claim for a tentative carryback adjustment or an amended tax return applying the NOL to the earliest carryback year once the IRS recommences accepting paper-filings, taxpayers should first understand the collateral impacts of the carryback. Similarly, due to the requirement to elect to skip Section 965 inclusion years on the earliest of these refund claims, these taxpayers will need to determine the collateral consequences of the transition-year-exclusion election. Taxpayers with NOLs arising first in tax years beginning in 2020 will have more time to assess these collateral consequences.

International tax considerations in carrying back an NOL and electing to skip Section 965 inclusion years include foreign tax credit implications, the creation or increase in a taxpayer's Section 59A Base Erosion and Anti-abuse Tax liability, and a reduction in a taxpayer's allowable Section 250 deduction.

IRS issues FAQs on interaction of NOL carrybacks and Section 965 inclusions

On 23 April 2020, the IRS issued instructions and other clarifying guidance in the form of FAQs for taxpayers that are claiming refunds under the new *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act) net operating loss (NOL) carryback provisions and have Section 965 transition tax liabilities during the carryback period.

As background, the CARES Act allows taxpayers to carry back NOLs arising in tax years beginning after 31 December 2017, and before 1 January 2021. Under Section 172(b)(3), taxpayers may also elect to waive the carryback period for NOLs arising in those years and carry them forward instead. Alternatively, Section 172(b)(1)(D)(v) allows taxpayers with one or more Section 965 inclusion years to elect to exclude all Section 965 inclusion years from the NOL carryback period. Revenue Procedure 2020-24 establishes the timing and methods for making these elections.

Under Section 172(b)(1)(D)(iv), a taxpayer that carries an NOL back to a Section 965 inclusion year is treated as having made a Section 965(n) election for each such year. The Section 965(n) election allows an NOL to be carried back to a Section 965 inclusion year only to reduce income exceeding the net Section 965(a) inclusion.

Following enactment of the CARES Act, the IRS issued guidance on filing Form 1139, *Corporation Application for Tentative Refund*, and Form 1045, *Application for Tentative Refund*, to claim refunds under the new NOL carryback provisions, including the ability to fax eligible forms to the IRS in lieu of mailing paper forms, which are not currently being processed.

The recently released FAQs provide additional guidance and reiterate that taxpayers can use Form 1139 and Form 1045 to apply for a tentative refund for a Section 965 inclusion year, contrary to the form instructions.

Election due dates

A taxpayer that wishes to waive the entire carryback period or to exclude its Section 965 inclusion years from the carryback period must elect to do so by:

- The due date (including extensions) for filing its return for its first tax year ending after 27 March 2020, for an NOL arising in a tax year beginning in 2018 or 2019
- The due date (including extensions) for filing its return for that tax year, for an NOL arising in a tax year beginning in 2020

Both elections are irrevocable.

Election to exclude Section 965 inclusion years

To elect to exclude *only* Section 965 inclusion years from the five-year NOL carryback period, taxpayers must attach an election statement to the first of the following three forms to be filed after 9 April 2020:

- The federal income tax return for the tax year in which the NOL arises
- A Form 1139 or Form 1045 applying the NOL to a tax year in the carryback period or
- An amended federal income tax return applying the NOL to the earliest tax year in the carryback period that is not a Section 965 year

Taxpayers that want to avail themselves of the "quick" refunds available for NOL carrybacks via Forms 1139 and 1045 should be mindful to meet the due dates for those forms and the related elections. The sole option of claiming a refund for a taxpayer that misses the filing deadline is to file an amended return for the carryback year, a process that requires Joint Committee on Taxation review before a refund over $2 million (or $5 million for C corporations) may be issued. Refunds requested through Forms 1139 and 1045 are only subject to JCT review after the refund has been issued.

Further, the IRS has issued temporary procedures for faxing Forms 1139 and 1045 to expedite the processing of these forms while IRS service centers remain closed. Amended returns that are mailed to the IRS will only be processed once the IRS re-opens and begins the daunting task of sorting through trailers full of accumulated mail.

IRS announces taxpayers can temporarily fax Forms 1139 and 1045 to claim NOL carrybacks and AMT credits under CARES Act

The IRS announced on 13 April 2020, that taxpayers can temporarily file by fax Form 1139 (refunds for corporations) and Form 1045 (refunds for individuals, estates, and trusts) to claim refunds under the net operating loss (NOL) carryback and alternative minimum tax (AMT) credit acceleration provisions of the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act).

Previously, these forms had to be paper-filed; with the closure of all IRS service centers, however, the agency is no longer able to process paper-filed returns. Consistent with the intent of the CARES Act to increase liquidity by getting cash into taxpayers' hands, the IRS has provided this temporary procedure to allow the processing of Forms 1139 and 1045 on an expedited basis. Taxpayers may fax the forms beginning on 17 April 2020, and until further notice.

Form 1139 can be used for Section 965(a) inclusion years

The IRS will also allow Form 1139 to be used to claim refunds for a Section 965(a) inclusion year, even though the instructions for Form 1139 prohibit such use. Under the CARES Act, however, a taxpayer with a carryback to a Section 965(a) inclusion year is deemed to have made an election under Section 965(n) limiting the amount of NOLs that may be carried back to that year. Thus, an NOL can only be carried back to an inclusion year to reduce income exceeding the amount of the net Section 965(a) inclusion.

While taxpayers seeking CARES Act-related refunds may also do so by filing an amended return for the affected years, Forms 1139 and 1045 will generally offer a quicker option in that claims filed on those forms are not subject to review by the Joint Committee on Taxation until ***after*** the claim has been paid. In contrast, large refund claims filed via amended returns (e.g., on Forms 1120-X or 1040-X) are subject to JCT review prior to payment, a process that can significantly delay payment, particularly in the current environment.

Given the limited scope of the returns qualifying for the IRS's temporary fax procedures, taxpayers should be careful to follow the previously described filing instructions as closely as possible to avoid a claim being rejected. Forms 1139 submitted by fax will be processed in the order received. Forms that do not qualify for the temporary fax procedures must be submitted in paper form and will not be processed until the IRS service centers re-open.

Because Forms 4466 and 1120X are not eligible to be filed by fax, taxpayers seeking quick refunds under the NOL and AMT credit provisions of the CARES Act should use Form 1139 to claim these benefits if at all possible. It is unlikely that the IRS will be able to process paper-filed returns (such as Forms 4466 and 1120X) as long as shelter-in-place orders remain in effect in the localities where the IRS's major service centers are located.

IRS provides relief for potential tax consequences caused by COVID-19 travel restrictions

The IRS in April 2020 issued two revenue procedures and frequently asked questions (FAQs) that provide guidance to certain individuals and companies affected by the international travel restrictions imposed under the COVID-19 emergency.

The FAQs provide relief for certain business activities conducted in the United States that could otherwise create a taxable presence or permanent establishment (PE) in the United States. They allow foreign persons to carry on a certain degree of US business activity, within a prescribed period, and not inadvertently create a US trade or business or, for treaty residents, a PE. Affected persons should retain contemporaneous documentation to establish the chosen COVID-19 Emergency Period and that the relevant activities would not have been otherwise performed in the United States. They may also consider filing protective returns, even if they believe they were not engaged in a US trade or business in 2020, to preserve benefits and protections such as statutes of limitations, deductions, and the ability to claim treaty-based relief.

Revenue Procedure 2020-20 provides relief to certain nonresident individuals who, but for the COVID-19 travel restrictions, would not have been in the United States long enough in 2020 to be considered resident aliens under the substantial-presence test of Section 7701(b)(3). Revenue Procedure 2020-27 provides that a US citizen or resident who left China on or after 1 December 2019, or another foreign country on or after 1 February 2020, will be treated as a qualified individual with respect to the period during which the individual was present in, or was a bona fide resident of, that foreign country if the individual establishes a reasonable expectation that he/she would have met the requirements of Section 911(d)(1) absent the COVID-19 emergency.

IRS withdraws 2004 Notice on 'Midco' transactions

The IRS in Notice 2020-19 withdrew Notice 2004-20, which identified as listed transactions so-called "Midco" transactions, in which an intermediary was used to facilitate the sale of non-US assets to take advantage of certain foreign tax credit provisions (and similar transactions). Notice 2020-19, issued in mid-April, indicates that Treasury and the IRS have concluded that the enactment of Section 901(m) "curtailed the use of these transactions because it effectively denies the foreign tax credits … under Section 901 or 902 (as in effect on 21 December 2017), as described in Notice 2004-20, or Section 960."

Final regulations under Section 901(m) were published on 20 March 2020.

Transfer pricing news

IRS releases FAQs on transfer pricing documentation best practices

The IRS has published new frequently asked questions (FAQs) describing best practices and common mistakes in preparing transfer pricing documentation. The guidance is designed to encourage and help taxpayers to prepare improved documentation with an aim to decrease the number of issues selected for examination and improve the examination efficiency for the issues that are selected.

The IRS states that the recommendations in the FAQs are consistent with the regulatory requirements for providing adequate and reasonable support for arm's-length pricing. The IRS believes that taxpayers may benefit from the insights in the FAQs by helping them to increase the chances of deselection of issues for audit earlier in the examination process.

The FAQs released by the IRS seem to encapsulate broad, long-standing IRS experience that the Section 6662(e) documentation it is receiving during audits is deficient. The consequences of deficient transfer pricing documentation are that the IRS raises more transfer pricing issues and examinations take longer. The FAQs describe specific areas for taxpayers to focus.

The FAQs should be viewed in the context of the IRS's continued focus on improving transfer pricing compliance and the effectiveness of its transfer pricing enforcement. While the IRS has done little to change the substantive transfer pricing rules during the last several years, it has changed to a risk-based issue identification process and has modified its examination process. It has issued several documents and directives explaining those changes; see, for example, directives related to the mandatory Information Document Request, transfer pricing method selection, and transfer pricing penalty application, as well as a document describing the Transfer Pricing Examination Process.

IRS updates FATCA FAQs

The IRS in late April 2020 updated its FATCA Frequently Asked Questions (FAQs) in regard to FATCA certifications due on 1 July 2020. The IRS will now grant an automatic extension of time to submit a FATCA certification for an entity that has a due date of 1 July 2020 to 15 December 2020, without needing to file an extension request. The IRS is also providing an extension for Model I Intergovernmental Agreement jurisdictions to provide their 2019 FATCA data to the US Competent Authority, extending the due date to 31 December 2020.

Taxpayers that wish to minimize transfer pricing audit exposure and expenditures for audit defense may want to evaluate whether their transfer pricing documentation is consistent with the recommendations in the FAQs.

In addition, the current economic volatility may create challenges for companies to comply with their existing transfer pricing structures. While the FAQs do not change current substantive or penalty law, consistent with the FAQs, taxpayers need to have robust documentation and check that their facts and results are consistent with that documentation.

IRS issues annual APA report for 2019

The IRS Advance Pricing and Mutual Agreement (APMA) Program recently issued the 21st annual Advance Pricing Agreement (APA) report, in Announcement 2020-2. The report provides a discussion of the APMA Program, including its activities and structure for calendar year 2019, and gives useful insights into its operation.

During 2019, 121 APA applications were filed and 120 APAs were completed. The number of APAs completed during 2019 is generally consistent with the number of APAs completed during the last several years. Additionally, there has been a continued interest in bilateral APAs, with Japan (32%), India (12%), and Canada (14%) representing 58% of all US bilateral APAs filed. At year end, 454 APA requests were pending (386 bilateral, 22 multilateral and 46 unilateral), down from 458 in 2018.

OECD news

OECD BEPS 2.0 project to continue on current timelines

There has been some speculation as to the future of the OECD Base Erosion and Profit Shifting (BEPS) 2.0 project against the backdrop of the ongoing COVID-19 pandemic. The steering group for the Inclusive Framework on BEPS in April 2020 held a week-long virtual meeting during which there was consensus to continue the project on the current timelines. The prevailing view was not to delay, with some countries concerned about the increasing pressure of unilateral action to enact a Digital Services Tax.

Some countries have noted that the reforms being developed with the BEPS 2.0 project are now more important than ever, as governments will need to begin to focus on revenue needs. At the same time, a variety of countries continue to express concern about the practical ability to address the major political issues and compromises necessary to move the project forward, particularly given that senior leaders in countries are focused on the demands of the current coronavirus crisis.

OECD Secretariat issues guidance on impact of the COVID-19 crisis on treaty-related issues

The OECD on 3 April 2020 published on its website an *OECD Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (the guidance).

Governments around the globe are taking increasingly stringent containment measures to slow the spread of the COVID-19 virus. As a result of these measures, many cross-border workers are unable to physically perform their duties in their country of employment. This unusual situation raises tax issues that could affect how the right to tax is divided between countries.

At the request of concerned countries, the OECD Secretariat has issued guidance on various issues based on an analysis of the international tax treaty rules. The guidance deals with issues related to:

- Creation of permanent establishments
- Residence status of companies (based on place of effective management)
- Treatment of cross-border workers
- Residence status of workers

The guidance provides a useful analysis of some treaty-related issues that arise because of dislocation caused by the COVID-19 crisis. However, the guidance is informational only and does not represent the official views of the OECD member countries. It also should be noted that the analysis reflected in the guidance only covers the OECD Model Tax Convention. Provisions in bilateral double tax treaties may differ from the OECD Model and such differences would need to be considered in analyzing the result in any particular situation.

In addition, the OECD has announced it is urgently working on other concerns raised by businesses, taxpayers and tax administrations due to the COVID-19 crisis. Therefore, more information may be coming from the OECD on other international tax questions that can arise in the current situation.

OECD releases second batch of Stage 2 peer review reports on dispute resolution

On 9 April 2020, the OECD released the second batch of Stage 2 peer review reports relating to the outcome of the peer monitoring of the implementation by Austria, France, Germany, Italy, Liechtenstein, Luxembourg and Sweden (the batch 2 jurisdictions) of the BEPS minimum standard on dispute resolution under Action 14 of the BEPS project. Stage 2 focuses on monitoring the follow-up of any recommendations that resulted from the batch 2 jurisdictions' Stage 1 peer review reports that were released on 15 December 2017.

The outcome of the Stage 1 peer review process for the batch 2 jurisdictions was that overall, the seven jurisdictions met most of the elements of the Action 14 minimum standard with respect to dispute resolution. Where deficiencies were identified, the Stage 2 monitoring showed that the jurisdictions have worked to address them. The Stage 2 reports for the batch 2 jurisdictions conclude that the assessed jurisdictions have addressed almost all or some of the identified deficiencies.

EY COVID-19 Trackers available

EY has developed a suite of COVID-19 tax development trackers to address the myriad tax changes that are occurring daily across the globe as a result of the coronavirus pandemic.

EY's suite of COVID tax development trackers, available on ey.com, include the following:

- Global COVID-19 Stimulus Tracker
- Force Majeure
- Tax Controversy
- Global Mobility
- Immigration Policy
- US State Taxes
- Global Trade, Customs and Excise Taxes
- Labor and Employment Law

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