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EY Tax News Update: Global Edition

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Legislation

Congress considers further action to address coronavirus pandemic

The US House voted on 15 May 2020, to approve the *Health and Economic Recovery Omnibus Emergency Solutions Act* (HEROES Act), H.R. 6800, a US$3 trillion stimulus package that proposes the next installment in COVID-19 legislation. The 1800 + page bill (the summary is 71 pages) was introduced by House Democrats on 12 May and includes $1 trillion in state and local funding, more direct payments, unemployment insurance, money for testing, and a host of other provisions.

The US Senate will not take up the bill, with Senate Majority Leader Mitch McConnell (R-KY) indicating the HEROES Act was a nonstarter.

The Majority Leader later in May confirmed that there is a "high likelihood" there will be another coronavirus bill enacted by Congress, probably within the next month.

In the meantime, the coronavirus pandemic has brought US government attention to various proposals to try and persuade manufacturers to reestablish their operations in the United States.

The Trump Administration's National Economic Council Director Larry Kudlow has continued to express interest in "onshoring" proposals after having previously floated the idea of a 10.5% rate for companies that bring operations back from overseas, saying "we're going to look at the numbers and assess what we think is necessary and not necessary."

In the House, Ways and Means Committee Chairman Richard Neal D-MA) was quoted as saying he wants to examine targeted incentives that reward corporations that move factories and jobs to the US, as part of negotiations over possible further legislation. Ranking Member Kevin Brady (R-TX) also said he planned to push for a targeted incentive aimed at companies that move overseas production to the US, including possibly lowering the 21% corporate income tax rate or a tax credit. "The top-line rate may stay the same, but they may get a credit underneath it. We haven't decided on whether it will be a credit or a rate reduction," Brady said.

On the Senate side, Senator Debbie Stabenow (D-MI) is reviving her *Bring Jobs Home Act* from previous Congresses. Her bill would grant business taxpayers a tax credit for up to 20% of insourcing expenses incurred for eliminating a business located outside the United States and relocating it within the US. It would also deny a tax deduction for outsourcing expenses incurred in relocating a US business outside the United States.

IRS news

IRS finalizes proposed Section 385 regulations with no substantive changes, leaves distribution rules in effect for now

Treasury and the IRS issued final regulations (TD 9897) under Section 385 on 13 May 2020, finalizing 2016 proposed regulations (81 FR 72751). The final regulations provide guidance for applying the Section 385 regulations to qualified short-term debt instruments, transactions involving controlled partnerships and transactions involving consolidated groups.

As background, final, temporary and proposed regulations under Section 385 were issued in 2016. The 2016 regulations contained rules in Reg. Sections 1.385-1, 1.385-3, 1.385-3T and 1.385-4T (the Distribution Regulations) that recharacterize a debt instrument issued by a domestic corporation as stock if the instrument is issued to a member of the domestic corporation's expanded group (i) in a distribution, (ii) in exchange for related-party stock or (iii) in exchange for property in certain asset reorganizations (each, a covered transaction).

The Distribution Regulations include a funding rule that recharacterizes as stock a debt instrument issued to a member of the issuer's expanded group in exchange for property (including money) to fund a covered transaction.

The 2016 Proposed Regulations cross-referenced identical 2016 temporary regulations, which applied until they expired on 13 October 2019.

2020 final regulations

The 2020 Final Regulations adopt the 2016 Proposed Regulations with no substantive changes. Accordingly, the 2020 Final Regulations include the following rules.

- *Qualified short-term debt instrument definition*. A qualified short-term debt instrument is exempt from the Distribution Regulations. The 2020 Final Regulations define the term "qualified short-term debt instrument" to include certain short-term funding arrangements, ordinary course loans, interest-free loans and deposits with cash pool headers.
- *Treatment of controlled partnerships*. The 2020 Final Regulations generally treat a controlled partnership as an aggregate of its partners. For this purpose, a controlled partnership is a partnership for which at least 80% of the interests in partnership capital or profits are held directly or indirectly by expanded group members. A debt instrument issued by a controlled partnership is not recharacterized as stock; rather, the 2020 Final Regulations treat the holder of such instruments as exchanging the debt instrument for stock of the controlled group partners.
- *Treatment of consolidated groups*. The 2020 Final Regulations generally treat a single consolidated group as a single corporation for purposes of the Distribution Regulations. The 2020 Final Regulations also provide operative rules for consolidated groups, including for corporations or debt instruments that enter or leave a consolidated group.

The portions of the 2020 Final Regulations relating to qualified short-term debt instruments and the treatment of controlled partnerships apply to tax years ending after 19 January 2017 (and for debt instruments issued after 4 April 2016).

Note that the expiration of the 2016 temporary regulations on 13 October 2019, coupled with the delayed applicability date of the 2020 Final Regulations for the consolidated return provisions, results in a "gap period" during which portions of the 2016 Proposed Regulations on consolidated groups are effectively elective.

The rules in Reg. Section 1.385-3 on qualified short-term debt instruments and controlled partnerships (other than when one or more expanded group partners is a member of a consolidated group), by contrast, were finalized retroactively, leaving no gap period for those rules.

The 2020 Final Regulations indicate that Treasury and the IRS continue to study the appropriate approach to making the Distribution Regulations more streamlined and targeted through future proposed regulations. The 2020 Final Regulations offer no additional information as to how, or when, new proposed regulations will be issued.

Any such relief would be prospective, so taxpayers must continue to navigate the current Distribution Regulations for all tax years before the finalization of any future guidance.

Treasury and IRS announce references to NAFTA in US tax treaties should be interpreted as references to the USMCA

Treasury and the IRS on 19 May 2020 announced (Announcement 2020-6) that, once the *Protocol Replacing the North American Free Trade Agreement with the Agreement between the United States of America, the United Mexican States, and Canada* (USMCA) enters into force, they will interpret references in US income tax treaties to the North American Free Trade Agreement (NAFTA) as references to the USMCA.

The NAFTA has governed trade relations between the United States, Mexico, and Canada since 1 January 1994, and many US tax treaties in force today contain explicit references to NAFTA (e.g., the derivative benefits test within the Limitation on Benefits (LOB) article), but do not mention agreements that might supersede it. As a result, questions have arisen regarding the application of treaty provisions referencing NAFTA once the USMCA enters into force.

Once the USMCA enters into force and replaces NAFTA, companies may continue to claim US tax treaty benefits by applying provisions that refer to NAFTA (such as the derivative benefits test) provided they meet all other requirements specified in the treaty for claiming such benefits.

The government noted that it will reach out to countries that have an applicable tax treaty containing references to NAFTA to confirm that those countries will similarly interpret references to NAFTA as references to the USMCA. While this outreach is ongoing, taxpayers claiming US treaty benefits can generally rely on the Announcement as to how Treasury and the IRS believe the reference should be applied.

IRS offers limited relief for filing Forms 8858 or 8865

The IRS on 7 May released Rev. Proc. 2020-30, providing limited relief under Section 1503(d) for the filing of Form 8858 or Form 8865 (controlled foreign partnership) by not taking into account "temporary activities" undertaken by individuals in a foreign country during a single consecutive period of up to 60 days during 2020, to the extent the individuals were temporarily present in the foreign country during that period and the activities would not have been undertaken but for "COVID-19 Emergency Travel Disruptions." The revenue procedure establishes documentation requirements for this purpose, which must be provided to the IRS upon request.

This relief is consistent with the recent IRS revenue procedures that provided relief for determining whether a US trade or business exists and the extent to which an individual qualifies for the benefits of the Section 911 foreign earned income exclusion.

Transfer pricing news

IRS announces modifications for filing APA and MAP requests, addresses pending and executed APAs

The IRS has announced modifications for filing advance pricing agreement (APA) and mutual agreement procedure (MAP) requests to allow for electronic filing and digital signatures. In the same announcement, the IRS also addressed questions about how the current economic environment is affecting the handling of pending and executed APAs by the Advance Pricing and Mutual Agreement program (APMA).

Filing modifications

Under the modifications, for documents requiring the taxpayer's signature under Revenue Procedure 2015-40 or Revenue Procedure 2015-41, the taxpayer may submit the documents with either (1) a scanned or photographed image of the taxpayer's signature or (2) the taxpayer's digital signature created using encryption techniques.

In addition, taxpayers may electronically file submissions required under Revenue Procedure 2015-40 or Revenue Procedure 2015-41. Filing paper copies is not required.

Pending and executed APAs

Regarding the impact of the current economic environment on pending and executed APAs, the announcement states that APMA is currently discussing various issues with taxpayers and treaty partners, including issues such as the application of transfer pricing methods in periods of economic distress and how the current economic conditions affect specific industries, types of taxpayers and regions. APMA is also able to discuss case-specific issues and concerns with taxpayers and treaty partners.

For purposes of coordinating and prioritizing APMA responses to these issues, the IRS requests that questions regarding executed APAs in which 2020 is a covered year be directed to the appropriate APMA Assistant Director and that questions regarding pending APAs including 2020 should be directed to the assigned APMA Team Leader.

OECD news

New refocusing on BEPS, OECD official says

Governments are ready to refocus their attention on the BEPS 2.0 project after having been sidetracked by the global COVID-19 pandemic, according to Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration. The OECD official was quoted at the end of May as saying that there has been significant progress in regard to revenue sourcing, scope, nexus, base determination and business line segmentation, and that these areas would be the subject of future public consultation.

He suggested that two key trends in the BEPS area have emerged in the current environment. Saint-Amans said that a number of countries are beginning to believe that it is possible to ring-fence the digital economy, pointing to the fact that digital companies are doing well during the pandemic and effectively ring-fencing themselves. The US government has been steadfast in its opposition to this point of view, arguing it is not possible to ring-fence the digital economy because the entire global economy is moving toward digitalization. The second trend, Saint-Amans reported, is that countries will not stand for tax avoidance by corporations that receive coronavirus stimulus funding.

While the OECD official said a third pillar is not being considered that would focus on a global excess profits tax as a means to raise revenue following the coronavirus pandemic, he suggested there could be a third pillar internally at the OECD that would focus on BEPS rules for lesser developed countries that may not benefit sufficiently from the original BEPS projects.

OECD holds public consultation on 2020 review of CbCR

The OECD on 12 and 13 May held a consultation with respect to its public consultation document: *Review of Country-by-Country Reporting (BEPS Action 13)*. The virtual consultation, was an opportunity for stakeholders to engage directly with the OECD Secretariat and the country delegates of the Inclusive Framework on BEPS on this review of the country-by-country (CbC) reporting standard and the implementation experience to date.

The Secretariat stressed that no decision has been made on what changes to the CbC reporting standard may be made as a result of the review. The Consultation Document does not represent the consensus views of the Inclusive Framework, and they noted that on many of the topics referenced in it, there is no agreement among the country delegates at this point.

Business representatives generally urged caution against making hasty changes to the rules that are currently in place, underscoring that CbC reporting was the product of a fragile consensus when it was introduced and has been a significant compliance burden for businesses.

One of the changes under discussion was a proposal to lower the reporting threshold for CbC reporting. It is worth noting that this threshold is being discussed in the BEPS 2.0 digitalization of the economy project as a possible threshold for application of new rules under both Pillar 1 and Pillar 2. Therefore, any change to the reporting threshold that results from the 2020 CbC reporting review could have significant implications for businesses that extend well beyond CbC reporting.

OECD hosts webcast offering update on tax work during COVID-19 crisis; July IF meeting delayed to October 2020

The OECD Secretariat on 4 May 2020 hosted a webcast to provide an update on its current work related to the COVID-19 crisis and to explain how the OECD has adapted its work on other projects because of the crisis.

In response to the COVID-19 crisis, the OECD is providing support to countries by gathering information on the responsive tax policy and tax administration actions that countries are taking and by analyzing cross-border tax issues that are arising. In parallel, the OECD continues its work on the full range of ongoing tax projects. Since the COVID-19 outbreak, the OECD has been publishing on its website, reports and other materials related to responsive tax developments to help taxpayers and countries during the crisis.

Regarding the project on addressing the tax challenges of the digitalization of the economy, the OECD indicated that progress is being made toward the objective of reaching agreement with respect to Pillar 1 and Pillar 2 by the end of 2020.

However, due to COVID-19, the planned July 2020 meeting of the Inclusive Framework on BEPS, together with the interim target of agreement on key policy features of new rules, has been postponed to October 2020. It was also noted that work on the project will continue into 2021.

The OECD is also considering addressing unique transfer pricing issues cropping up as a result of the COVID-19 pandemic. Working Party 6, which will establish a work process in this area, is not expected to release any guidance before the end of 2020.

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