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OECD releases Pillar 1 and Pillar 2 blueprints, invites public comments

The OECD and the Inclusive Framework on BEPS on 12 October 2020 released a series of documents in connection with the ongoing project on addressing the tax challenges arising from the digitalization of the economy, commonly known as the BEPS 2.0 project. The project, which began in early 2019, consists of two elements: Pillar One focused on developing new nexus and profit allocation rules and Pillar Two focused on developing global minimum tax rules.

The released documents include detailed reports on the Blueprints on Pillar One (Report) and Pillar Two (Report); a lengthy Economic Impact Assessment (Report) of the Pillar One and Pillar Two proposals; a Cover Statement by the Inclusive Framework on the work to date and the next steps; a Public Consultation Document requesting comments on the Blueprints on both Pillars; and a Report to the G20 Finance Ministers for their 14 October 2020 meeting.

The OECD held both an on-line press conference and a webcast to update the press and the public on the latest developments in the BEPS 2.0 project.

According to the Inclusive Framework Cover Statement, even though substantial progress has been made on the BEPS 2.0 work, key political and technical issues still need to be resolved. As a result, the initial timeline for delivering a consensus-based solution by the end of 2020 will not be met. The Inclusive Framework has now agreed to continue working to bring the process to a successful conclusion by mid-2021, specifically noting the need "to resolve technical issues, develop model draft legislation, guidelines, and international rules and processes as necessary to enable jurisdictions to implement a consensus-based solution."

The public consultation on the Pillar One and Pillar Two Blueprints will be open for stakeholder input until 14 December 2020 and all written comments received will be made publicly available. Public consultation meetings on the Blueprints will be held in January 2021.

On 14 October, the G20 Finance Ministers and Central Bank Governors met via teleconference and at the conclusion of the meeting issued a joint communiqué that touched on the BEPS 2.0 project. The communiqué reaffirmed the G20's commitment to making further progress on the two-pillar approach and stressed the importance of addressing the remaining issues in order to reach a global and consensus-based solution by mid-2021.

The extension of the BEPS 2.0 mandate to mid-2021 raises questions regarding the implications for existing and pending Digital Services Taxes (DST). In particular, France has suspended the collection of its DST until the end of 2020 under the condition that a global agreement would be reached by then. In light of the new G20 timeline, it is expected that France will communicate soon on whether it will extend the suspension pending the continued OECD negotiations. Other countries have been contemplating potential action on new DST legislation by the end of the year.

A European Commission spokesperson quickly provided the European Union's (EU) response to the latest developments. The official was quoted as saying the EU will not take unilateral action and will wait and abide by the new OECD Inclusive Framework timeline. The official indicated, however, that the EU will take unilateral action if the BEPS 2.0 process breaks down.

The proposals under Pillar One and 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 businesses operate. It is important for businesses to follow these developments closely in the coming months and to consider engaging with the OECD and policymakers at both national and multilateral levels on the business implications of these proposals. Businesses also should evaluate the potential impact of these proposed changes.

UN subcommittee releases new proposed treaty article on digital taxes

A United Nations (UN) digital taxation subcommittee on 11 October 2020 issued a note that includes a new proposed model treaty article and commentary on taxing the digital economy. New Article 12B (Income from Automated Digital Services), is proposed to be incorporated in the UN Model Double Taxation Convention Between Developed and Developing Countries.

IRS news

Final regulations under Section 1446(f) set forth rules on withholding on transfers of partnership interests

Treasury and the IRS on 7 October 2020 published final partnership withholding regulations (TD 9926) under Section 1446 with regard to dispositions of certain partnerships engaged in a US trade or business.

Section 1446(f), enacted by the *Tax Cuts and Jobs Act*, imposes a new withholding tax on transfers by non-US persons of interests in partnerships that are engaged in a US trade or business. Section 1446(f) is an enforcement mechanism for the substantive tax imposed by Section 864(c)(8), which imposes tax on non-US partners that sell interests in such partnerships to the extent the gain is allocable to the partnership's US business assets.

The final regulations retain the basic approach and structure of the proposed regulations (REG-105476-18) issued in May 2019, with certain revisions. They retain the general rule in Proposed Reg. Section 1.1446(f)-2(a) that requires withholding on the transfer of a partnership interest unless an exception or adjustment to withholding applies. The final regulations add a rule, however, that provides that any person that is required to withhold under Section 1446(f) is not liable for failure to withhold if it can establish that the transferor had no gain under Section 864(c)(8) that is subject to tax on the transfer.

The final rules also add a withholding exception if the partnership certifies to the transferee that it is not engaged in a US trade or business. The same exception is added for a publicly traded partnership (PTP) that is not engaged in a US trade or business.

Responding to comments, the IRS stated that it has determined that a PTP should not be required to withhold under Section 1446(f)(4). The final regulations remove the requirement in the proposed regulations that a PTP withhold on a transferee under Reg. Section 1.1446(f)-3 and add instead provisions imposing liability for underwithholding under Section 1461 if the partnership issued an incorrect qualified notice upon which brokers relied to not perform the required withholding.

There are numerous provisions affecting PTPs, and PTPs and the securities industry will face challenges, including:

- Considerably less time to implement Section 1446(f) withholding and reporting than requested, coupled with a more challenging work environment due to the pandemic
- The need to implement a new withholding regime on gross proceeds paid to foreign persons
- The need to potentially withhold twice on the same distribution from a PTP
- The need to obtain documentation and potentially withhold in a delivery versus payment transaction

Asset managers for non-PTP interests should be establishing policies and procedures to manage requests for information to determine amounts realized and other relevant information. Additionally, for the partnership interest transferred, asset managers will want to have a process in place to manage receipt of notifications from the transferee that the withholding obligation has been satisfied. If a transferee fails to perform its Section 1446(f) withholding obligation, the partnership is responsible for backstop withholding.

The final regulations generally apply to transfers that occur on or after the date that is 60 days after their date of publication in the Federal Register. However, different applicability dates apply for specific provisions. Certain provisions, including those applicable to transfers of PTP interests and secondary withholding tax liability of a partnership when a transferee fails to withhold, apply to transfers that occur on or after 1 January 2022. Other specified provisions, consistent with their proposed applicability dates, apply to transfers occurring on or after the date of publication of the final regulations in the Federal Register.

New IRS compliance campaign targets NRAs that fail to report US property rental income

The IRS Large Business and International Division (LB&I) has announced a new compliance campaign that takes aim at nonresident aliens that fail to report rental income from US property. According to the IRS's 5 October announcement, this campaign will address noncompliance through examinations, education, and outreach.

Calendar year 2019 FBARs extended to 31 October

In response to concerns over taxpayer reliance on an earlier communication, FinCEN formally issued a notice on 16 October 2020 extending 2019 calendar-year FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR) filings to 31 October 2020. The filings were previously due on 15 October 2020, as automatically extended from 15 April 2020.

IRS concludes anti-abuse rule under Section 704(c) triggered in asset contribution to foreign partnership

In an IRS Office of Chief Counsel Memorandum (FAA 20204201F), the government has advised that the Section 704(c) anti-abuse rule applies to contributions that a US corporate taxpayer made of high-value, low-basis assets to a partnership formed with a related foreign entity. The partnership used the "traditional method," with curative allocations limited to gain on the disposition of the contributed property, for making allocations with respect to the built-in gain for purposes of Section 704(c). The IRS determined that it may exercise its authority to apply a "curative method" that would cure the distortion.

The FAA is significant for several reasons. First, it provides insight on the IRS's view of the application of the Section 704(c) anti-abuse rule. Second, the FAA raises questions concerning the IRS's interpretation of the "with a view to" requirement in the Section 704(c) anti-abuse rule; more specifically, the FAA suggests that the IRS may seek to apply the Section 704(c) anti-abuse rule even to partnership contributions that were partially motivated by valid non-tax business purposes. Third, it confirms that the IRS cannot apply the remedial allocation method to remedy an adoption of a Section 704(c) method that violates the Section 704(c) anti-abuse rule.

Although the Section 721(c) regulations did not apply to the contributions in the FAA, those regulations impose certain requirements that are relevant to taxpayers considering a similar transaction. The regulations under Section 721(c) deny nonrecognition treatment to certain contributions of appreciated property by US persons to partnerships with related foreign partners unless the partnership satisfies specific requirements.

To avoid gain recognition, the partnership must, among other things, adopt the remedial allocation method under Section 704(c) and the consistent allocation method in the Section 721(c) regulations, in each case with respect to the transferred property. Under the remedial allocation method, a ceiling rule limitation is "cured" each year by having the partnership allocate (i) notional items to the non-contributing partner to ensure its allocation of tax items matches its allocation of Section 704(b) items (tax amortization deductions, for example) and (ii) offsetting notional items to the contributing partner (taxable income, for example).

IRS confirms some modifications to debt instruments, other contracts to reflect LIBOR discontinuation will not result in a deemed taxable exchange

In Revenue Procedure 2020-44, the IRS confirmed that certain fallback language modifying debt instruments, derivatives, and other financial contracts to cover the possible discontinuance of the London Interbank Offered Rate (LIBOR) will not cause a deemed taxable exchange for US federal income tax purposes. The confirmation also applies to other "interbank offered rates" (IBORs), such as the Euro Interbank Offered Rate (EURIBOR).

In addition, the IRS confirmed that the modifications will not change the tax treatment of a "synthetic" debt instrument (i.e., an integrated debt instrument and hedge under Reg. Sections 1.988-5 or 1.1275-6).

In October 2019, the IRS issued proposed regulations (REG-118784-18) addressing certain tax issues related to the transition to alternative reference rates Although these proposed regulations have not been issued in final form, taxpayers may currently rely upon them. The IRS issued the Revenue Procedure as interim guidance on which taxpayers could rely until the proposed regulations are finalized.

The latest confirmation is relevant for (1) any issuer or holder of a floating debt instrument bearing interest based on LIBOR and (2) any party to a derivative contract, insurance contract, lease, or other contract that provides for payments based on LIBOR.

The Revenue Procedure applies to contract modifications made on or after 9 October 2020, and before 1 January 2023, but can be relied on for contracts modified before 9 October 2020.

Given the very large number of financial instruments referencing LIBOR and other IBORs, the demise of these indices will affect numerous taxpayers. Revenue Procedure 2020-44 provides welcome guidance on one of the most pressing issues — whether the addition of contract language to handle a future transition to a new interest rate benchmark will result in a taxable exchange of an instrument referencing LIBOR or other IBORs for a new instrument.

The Revenue Procedure, in an improvement over the proposed regulations, also provides some specific guidance on how the transition would apply when an instrument and a hedge are integrated under Reg. Sections 1.988-5 and 1.1275-6.

The Revenue Procedure is, however, limited to only certain, specific modifications. Specifically, it permits the incorporation of certain model fallback provisions, but by its terms does not apply to the addition of fallback language that does not follow the Alternative Reference Rates Committee (ARRC) or International Swaps and Derivatives Association (ISDA) model language, or to an immediate changeover to an alternative reference rate.

Moreover, it does not address other issues addressed in the proposed regulations, such as the effect of the transition from LIBOR under the REMIC rules of Section 860G and the Section 882 rules for determining the deductible interest expense of a foreign corporation engaged in business in the US. In addition, neither the proposed regulations nor the Revenue Procedure addresses other issues related to the transition from LIBOR, such as: tax accounting for one-time payments; change to the fair market value of modified instruments; or margined derivative transactions.

Taxpayers (and their foreign entities) need to evaluate all floating-rate debt instruments they hold or have issued, as well as derivative and other transactions into which they have entered, to determine if the Revenue Procedure may be relied upon to avoid the realization of gain or loss from contract modifications to include fallback language to account for the possible discontinuation of LIBOR.

Transfer pricing news

IRS ‘practice unit’ sets forth examination guidance on inclusion of stock based compensation in cost sharing arrangements

As part of the IRS Large Business and International Division’s (LB&I’s) knowledge management efforts, on 30 September 2020, the IRS released a new practice unit titled “Cost Sharing Arrangements with Stock Based Compensation” (DCN INT-T-226). The practice unit focuses on the inclusion of stock-based compensation (SBC) as an intangible development cost (IDC) under a cost sharing arrangement (CSA) subject to Reg. Section 1.482-7 and provides guidance for tax audits together with relevant resources (the SBC practice unit).

The SBC practice unit is the most recent IRS guidance regarding the inclusion of SBC as an IDC since the conclusion of the *Altera* matter.

(On 22 June 2020, the US Supreme Court announced that it was denying the petition for certiorari for *Altera Corporation & Subsidiaries v. Commissioner*. Altera filed the petition asking the Supreme Court to review a decision of the Ninth Circuit Court of Appeals upholding the 2003 version of Reg. Section 1.482-7, which requires participants to include stock-based compensation costs in a cost-sharing arrangement. The denial to hear the case put an end to Altera’s Ninth Circuit stock-based compensation challenge.)

The SBC practice unit is the first IRS guidance concerning CSAs with SBC since the conclusion of the *Altera* case and is a strong indication that the IRS plans to aggressively audit the inclusion of SBC in CSAs for taxpayers located both inside and outside of the Ninth Circuit. Given the IRS’s favorable outcome in *Altera*, the IRS will likely continue to pursue this issue until it is ultimately resolved by the courts through either appellate decisions or an opinion of the United States Supreme Court.

As a result, taxpayers with CSAs should review and evaluate their positions regarding the inclusion of SBC costs, paying particular attention to the examination methods prescribed in the SBC practice unit.

IRS announces plans to limit use of 'telescoping' in APA and MAP cases

The IRS's Advance Pricing and Mutual Agreement program (APMA) on 28 October 2020 announced that it is updating the parameters that it follows in mutual agreement procedure (MAP) and advance pricing agreement (APA) cases. The updates are expected to significantly restrict the use of "telescoping" of results in MAPs and APAs.

Telescoping refers to reflecting an income tax adjustment in a year different from the year to which the adjustment relates. Taxpayers sometimes request this departure from the notion of annual accounting in a MAP or APA to relieve the administrative burden of filing multiple amended federal and state income tax returns. APMA occasionally allowed taxpayers to do this, under the authority of an income tax treaty. The *Tax Cuts and Jobs Act* (TCJA) changed substantive provisions of the Code. Thus, different tax rates and other rules may apply to similar related-party transactions, depending on which year they occur.

Under the new APMA parameters, taxpayers must generally amend the applicable year's (or years') federal income tax return rather than reflect the changes to taxable income in a most current tax year. For cases with pre- and post-TCJA years, the IRS states that changing the US taxpayer's taxable income under a competent authority resolution is likely to impact the substantive calculation of tax. APMA's updates to the telescoping parameters are intended to promote compliance with the changes brought to US tax law by the TCJA. Many of the TCJA's interlocking provisions require careful determination of a US taxpayer's taxable income and tax attributes.

Taxpayers should review their current MAP and APA cases to determine whether telescoping is allowed in their situation and whether it makes sense, given their facts. Moreover, taxpayers considering filing a MAP or APA request should be aware of the new APMA parameters, as the limitations on telescoping will change some practices to which taxpayers may have grown accustomed over the years.

IRS will consider amending existing APAs to reflect COVID-19 economic conditions

The head of the IRS Advance Pricing and Mutual Agreement Program (APMA) in October 2020 was quoted as saying that the IRS will consider amending existing advance pricing agreements (APAs) because of the economic implications from the COVID-19 pandemic, but it will not be automatic. The official indicated that APMA will consider requests on a case-by-case basis for early termination of existing APAs that will run through 2020. He cautioned, however, that consideration of such requests does not mean the IRS will accept changes to the transfer pricing method absent compelling justification.

The APMA program expects to see a large number of requests for APA amendments due to the pandemic's economic fallout after 2020 financial results become available.

There reportedly also are no plans by APMA to release formal guidance in regard to APAs or mutual agreement procedures that address the effects of the COVID-19 pandemic.

US-Hong Kong shipping agreement will terminate effective 1 January 2021

The US Government announced (Announcement 2020-40) that the 1989 US-Hong Kong shipping agreement will be terminated effective 1 January 2021, effective for taxable years beginning on or after that date. Last summer, President Trump issued an Executive Order on Hong Kong Normalization, which, among other things, directed that notice be given to Hong Kong of the US Government's intent to terminate the shipping agreement.

OECD developments

OECD issues third batch of Stage 2 peer review reports on dispute resolution

On 22 October 2020, the OECD released the third batch of Stage 2 peer review reports relating to the outcome of the peer monitoring of the implementation by the Czech Republic, Denmark, Finland, Korea, Norway, Poland, Singapore and Spain (the batch 3 jurisdictions) of the BEPS minimum standard on dispute resolution under Action 14 of the BEPS project.

These Stage 2 reports focus on evaluating the progress made by batch 3 jurisdictions in addressing any of the recommendations that resulted from the Stage 1 peer review reports that were released on 12 March 2018. Denmark, Poland and Singapore had also requested that the OECD provide feedback concerning their adoption of the Action 14 best practices, and the OECD therefore also released three accompanying best practices reports.

The outcome of the Stage 1 peer review process for the batch 3 jurisdictions was that overall, the eight 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 reflects that most of the assessed jurisdictions have worked to address them. The Stage 2 reports for the batch 3 jurisdictions conclude that the assessed jurisdictions have addressed some or almost all of the deficiencies identified in Stage 1, with the exception of the Czech Republic and Spain.

OECD to release COVID-19-related transfer pricing guidance

The OECD reportedly plans to release practical guidance in the transfer pricing area this year that addresses issues specifically related to the COVID-19 pandemic. The guidance will be in response to a recent consultation that took place following a questionnaire that was issued to multinationals last summer, requesting information on pressing transfer pricing issues.

An OECD official in October was quoted as saying that the most important issue cited by both multinationals and governments is the allocation of government support that has taken place as a result of the pandemic. Governments are concerned that the aid they have provided not be transferred abroad through transfer pricing arrangements. Other issues that are likely to be covered in the coming guidance include benchmarking 2020 financial results, loss allocation to limited risk entities and the effects of the COVID-19 pandemic on advance pricing agreements.

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