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Legislation

US Congress passes coronavirus stimulus and omnibus spending package that includes extension of CFC look-through

After months of negotiation, the US House and Senate on 21 December 2020 approved the *Consolidated Appropriations Act, 2021* (Act), a 5,593 page, $2.3 trillion spending and coronavirus stimulus package.

The Act provides roughly $900 billion in coronavirus relief, including many tax and health components, as well as a $1.4 trillion omnibus appropriations package to fund the Federal Government through September 2021. Among the highlights are $284 billion for another round of payments through the Paycheck Protection Program (PPP), a $300 per week federal unemployment benefit through 14 March 2021, and $600 stimulus checks, as well as numerous other provisions.

The year-end bill also included a significant "extenders" package addressing expiring tax provisions, making several provisions permanent and aligning others with the scheduled expiration of tax cuts under the *Tax Cuts and Jobs Act*. Among the measures that would be extended through 2025 is the CFC look-through rule.

President Trump on 27 December 2020 signed the bill into law, but not before indicating he supported a change to the coronavirus relief legislation and wanted Congress to pass a new bill that would increase the stimulus payments from $600 in the current bill to $2000.

Treasury and IRS news

IRS issues final and proposed PFIC regulations that provide mix of favorable and unfavorable provisions

In final and proposed regulations released on 4 December 2020, Treasury and the IRS provided guidance on the passive foreign investment company (PFIC) rules under Sections 1291, 1297 and 1298 (the final PFIC regulations and the 2020 proposed regulations, respectively).

The final PFIC regulations are largely consistent with the proposed PFIC regulations released on 10 July 2019, but contain several significant changes.

In particular, the final PFIC regulations:

- Clarify an ambiguity about how ownership of PFIC stock is attributed when owned through a tier of entities
- Eliminate reliance on the Section 954(h) active financing rules when determining whether a foreign corporation carrying on a financial business is a PFIC
- Eliminate rents and royalties from 25%-owned subsidiaries, and the associated assets, from the PFIC income and asset tests
- Eliminate the ability to treat a less-than-25% (by value) interest in a partnership as an active asset (with exceptions)
- Allow one to take into account activities of related parties when determining whether rents, royalties and certain other types of income are passive or active
- Allow foreign corporations that are only controlled foreign corporations because of the repeal of Section 958(b)(4) in 2017 to measure assets by fair market value for purposes of the PFIC asset test
- Modify the rules on when stock in a second-tier US subsidiary is treated as per se active

The 2020 proposed regulations would notably:

- Provide guidance on when a foreign corporation licensed as a bank can avoid being treated as a PFIC
- Treat as an active asset a limited amount of working capital held in a non-interest-bearing account
- Limit the scope of the rule treating gain on the sale of an interest in certain subsidiaries as active to the extent the subsidiary owns active assets
- Further modify the rules on when stock in a second-tier US subsidiary is treated as per se active

Both the final PFIC regulations and the 2020 proposed regulations materially change the rules for when a foreign insurance company will be treated as a PFIC. (For details, see the following article in this issue of the *Washington Dispatch*.)

Final and proposed regulations on passive foreign investment companies have both favorable and unfavorable implications for insurance companies

Final regulations (T.D. 9936; Final Regulations) and proposed regulations (REG-111950-20; 2020 Proposed Regulations) under the passive foreign investment company (PFIC) rules include provisions that significantly affect insurance companies. Those provisions include:

- Detailed guidance on the identification of applicable insurance liabilities, computation of the ratio of applicable insurance liabilities to total assets, identification of the applicable financial statement and adjustments required to amounts reported on the applicable financial statement
- Modified standards for determining when a foreign insurance company is in "runoff-related" or "ratings-related" circumstances
- Re-proposed guidance on the active conduct test, which would favorably permit active conduct to be demonstrated by meeting either a facts-and-circumstances test or a modified active-conduct-percentage test that excludes investment activities
- Rules on the treatment of certain subsidiaries and partnerships held by a qualifying insurance corporation (QIC) that would limit the amount of assets and income derived by such entities that is treated as non-passive
- Rules that treat the assets and income of a domestic insurance company subsidiary of a foreign parent as non-passive, subject to a limitation that is part of the 2020 Proposed Regulations

The Final Regulations apply to tax years of US persons that are shareholders in certain foreign corporations prospectively, beginning on or after the date of publication of the Final Regulations in the Federal Register.

Treasury to focus on other international projects, tax treaties as TCJA guidance nears completion

A senior Treasury official in mid-December 2020 was quoted as saying that with *Tax Cuts and Jobs Act* (TCJA) guidance nearly complete, Treasury will now refocus on several other international tax areas, including regulations under Sections 959 and 961, 897, and 864(f) – the latter being allocation of interest on a worldwide basis – as well as other projects listed on the IRS's 2021 priority guidance plan.

The official also indicated that Treasury is making progress on a new tax treaty with Croatia. Based on the comments made, it would appear that work on other treaties may also be underway. The official further highlighted the resumption of Senate approvals of bilateral tax treaties after nearly a decade of having been blocked from Senate approval.

Treasury's FinCEN further extends certain signature authority reporting (FBAR, Form 114) over foreign financial accounts

On 11 December 2020, the US Financial Crimes Enforcement Network (FinCEN) released Notice 2020-1, further extending the filing deadline for certain individuals who previously qualified for an extension of time to file the Report of Foreign Bank and Financial Accounts (FBAR) with respect to signature authority under Notice 2019-1 and previous guidance.

The Notice pertains only to individuals who were initially granted extensions of time to report signature authority under FinCEN Notices 2011-1 and 2011-2 (most recently extended by FinCEN Notice 2019-1). Under the Notice, individuals have until 15 April 2022, to file deferred FBARs, subject to any potential further extension. Any persons not covered by the Notice for 2020 will have until 15 April 2021 – automatically extended to 15 October 2021 – to file their FBARs for the 2020 calendar year.

In no case is an extension (beyond the automatic extension to 15 October) available for financial interest filing obligations.

Transfer pricing news

Transfer pricing enforcement remains priority even while TCJA provisions may negate adjustments

A senior IRS Large Business and International Division (LB&I) official in December 2020 indicated that the IRS will continue to prioritize transfer pricing enforcement in its examinations, even when the tax effect of an adjustment could be largely negated by one of the *Tax Cuts and Jobs Act's* (TCJA) international provisions.

For example, while the new Base Erosion and Anti-abuse Tax (BEAT) or Global Intangible Low-taxed Income (GILTI) rules may limit the tax impact of a transfer pricing adjustment, the Government remains committed to "ensuring that taxpayers are pricing their related-party transaction at an arm's-length price."

The official was quoted as saying that neither BEAT nor GILTI will be determinative as to whether the IRS moves forward with a transfer pricing adjustment. The LB&I official added that the "new overlapping TCJA provisions are just another factor" that the Government will take into consideration when assessing what will be examined and where to direct IRS resources.

IRS APMA seeing more queries on transfer pricing consequences of coronavirus pandemic

The Director of the IRS Advance Pricing and Mutual Agreement (APMA) Program said in early December that the US Government is seeing more questions about the transfer pricing consequences of the COVID-19 pandemic from taxpayers with existing, or in process, advance pricing agreements (APAs).

John Hughes, APMA's Director, was quoted as saying APMA will work with its foreign counterparts for taxpayers in the APA negotiation phase, to develop a method that avoids possible complications resulting from the pandemic. It will be more difficult to address the pandemic for those with existing APAs, Hughes said. In those cases, APMA will need "good, cold, hard data" to determine whether the APA should be modified. "We need to know exactly what happened with your business, and exactly what is the assistance that you're seeking."

OECD developments

OECD issues guidance on transfer pricing implications of COVID-19, hard-to-value intangibles

On 18 December 2020, the OECD released a report containing guidance on the transfer pricing implications of the COVID-19 pandemic (the Report). The Report notes that the unique economic conditions arising from COVID-19 and government responses to the pandemic have led to practical challenges for the application of the arm's-length principle.

According to the Report, the arm's-length principle and the OECD Transfer Pricing Guidelines for Multinational Enterprises (MNEs) and Tax Administrations 2017 (OECD TP Guidelines) should continue to be relied upon by tax administrations and MNEs when performing a transfer pricing analysis, including under the possibly unique circumstances introduced by the pandemic.

The Report focuses on how the arm's-length principle and the OECD TP Guidelines apply to issues that may arise or are exacerbated in the context of the COVID-19 pandemic, rather than on developing specialized guidance beyond what is currently addressed in the OECD TP Guidelines. The Report focuses on four priority issues where it is recognized that the additional practical challenges posed by COVID-19 are most significant: comparability analysis; losses and the allocation of COVID-19 specific costs; government assistance programs; advance pricing agreements.

IRS will continue ICAP joint risk assessment initiative

An IRS spokesperson in December 2020 was quoted as saying the agency "intends to continue in ICAP [International Compliance Assurance Program] as it transitions from a pilot to an established FTA [Forum on Tax Administration] program in 2021." The IRS spokesperson said more information on the ICAP program will be provided in early January 2021.

The news follows an OECD FTA meeting in December during which the FTA announced that the piloted International Compliance Assurance Program will become an established program among an expanded group of tax administrations. ICAP, a voluntary joint risk assessment initiative that is designed to stem the flow of issues into mutual agreement procedures, has been piloted by a small group of major tax administrations, including those of Australia, Canada, Italy, Japan, the Netherlands, Spain the United Kingdom and the US, along with several multinational enterprises. More information on the program is available on the OECD's ICAP website.

These issues have been presented as discrete topics in the Report, but it is emphasized that in performing a transfer pricing analysis, these topics may be interrelated and therefore should be considered together and within the analytical framework of the OECD TP Guidelines.

The OECD on 16 December also published jurisdiction-specific information on the status of implementation of the hard-to-value intangibles (HTVI) approach by members of the Inclusive Framework. The information is meant to provide a better understanding of the extent to which the HTVI approach "has been adopted and applied in practice by countries around the world, with the aim to reduce misunderstandings and disputes between governments." The information was provided by the countries in response to a questionnaire.

OECD releases fourth peer review report on BEPS Action 5 on the Exchange of Information of Tax Rulings

On 15 December 2020, the OECD released the fourth annual peer review report relating to compliance by members of the Inclusive Framework on BEPS with the minimum standard on BEPS Action 5 for the compulsory spontaneous exchange of certain tax rulings (the transparency framework).

The report, which covers 124 of the 137 current Inclusive Framework jurisdictions, assesses the 2019 calendar-year period and contains recommendations for 43 jurisdictions to improve their legal or operational framework to identify and exchange tax rulings. Further, the report indicates that by 31 December 2019 almost 20,000 tax rulings within the scope of the transparency framework had been issued by the jurisdictions under review and over 36,000 exchanges of information had taken place.

This report is the final report for the peer review process on BEPS Action 5, as agreed in the current review methodology.

OECD's FTA hosts virtual meeting of tax administration leaders

On 7-8 December 2020, the OECD Forum on Tax Administration (FTA) held its annual plenary meeting virtually for the first time, bringing together more than 300 delegates from the 53 jurisdictions that are members of the FTA, which includes all OECD and G20 members.

The discussions focused on a variety of tax administration issues, including responses to the global pandemic, emerging risks, digital transformation and tax certainty, Four reports also were released, addressing tax issues for Small and Medium-Sized Enterprises, the digital transformation of tax administration, international tax debt management, and the compliance of financial institutions with information submission requirements.

BEPS 2.0 Pillar One and Two comment period closes; public consultation set for 14-15 January 2021

The OECD on 14 December closed its comment period for the BEPS 2.0 Pillar One and Pillar Two project. The public consultation meeting on the Pillar One and Two Blueprints will be held virtually on 14-15 January 2021 and the current timetable calls for reaching a global consensus by mid-2021.

Among the comments received were those of the Business at OECD (BIAC), an officially recognized business voice to the OECD. In addition to providing detailed comments on the two Pillars, BIAC suggested that with time running out to reach a consensus agreement "consideration … be given to reaching a more limited agreement by June 2021, coupled with a binding undertaking to engage in a more fundamental medium- to long-term discussion."

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