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Year-in-Review

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This special issue of the Washington Dispatch is a compilation of significant US international tax developments and guidance issued during the period of 1 January through 31 December 2020, addressing inbound and outbound taxation. The material is divided by subject area with most recent events listed first.

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Section 163(j) interest expense limitation

Final Section 163(j) regulations generally applicable to tax years on/after 13 November 2020

The Section 163(j) final regulations (TD 9905) that were released in July 2020 were published on 14 September 2020. Based on this publication date in the Federal Register, the final regulations are generally applicable to taxable years beginning on or after 13 November 2020. Therefore, for a calendar year taxpayer, the final rules generally would be effective for taxable years beginning 1 January 2021.

Taxpayers may choose to apply the final regulations to a taxable year beginning after 31 December 2017 and before the effective date of the final regulations. In that case, however, the taxpayer must consistently apply the rules under the Section 163(j) regulations, and if applicable, the final regulations modifying other regulation provisions set forth in TD 9905 (for example, Reg. Section 1.263A-9) to that taxable year.

Note that different applicability dates may apply with respect to anti-avoidance rules, and each section has its own specific provisions with respect to applicability dates that should be reviewed when determining applicability dates based on the taxpayer's particular facts and circumstances. (See the article below for details.)

IRS issues final and proposed interest expense limitation regulations

Treasury and the IRS on 28 July 2020 released final regulations (TD 9905) and proposed regulations (REG-107911-18) on the business interest expense limitation under Section 163(j) (the Section 163(j) Limitation). The Section 163(j) Limitation was modified in December 2017 by the *Tax Cuts and Jobs Act* (TCJA), and in March 2020 by the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act).

At the same time, the IRS issued Notice 2020-59, which creates a safe harbor allowing taxpayers that manage or operate qualified residential living facilities to be treated as a real property trade or business solely for purposes of qualifying as an electing real property trade or business. The government also released FAQs on the aggregation rules that apply for purposes of the gross receipts test and determining whether a taxpayer is a small business exempt from the Section 163(j) deduction.

The eagerly-anticipated final regulations provide guidance on:

- Items treated as interest expense and interest income for purposes of Section 163(j)
- The exclusion of certain small taxpayers and trades or business from the Section 163(j) Limitation
- The application of the Section 163(j) Limitation to consolidated groups, partnerships, foreign corporations, trusts and other taxpayers (such as REITs)
- The interaction of Section 163(j) with other deferral, disallowance and capitalization rules
- Ordering rules for taking into account previously disallowed interest expense
- Elections for excepted trades or businesses and how to allocate interest expense, interest income and other items
- Coordination of the final regulations with the provisions of the CARES Act

There are significant changes in the final regulations, as compared to the former proposed regulations, including:

- Narrowing the proposed scope of the items treated as interest income and expense to exclude commitment fees, debt issuance costs, and gains/losses from certain hedging transactions, except in cases of abuse
- Permitting taxpayers to add depreciation, amortization or depletion allowances that are capitalized into inventory under Section 263A to "tentative taxable income" when calculating adjusted taxable income (ATI) for tax years beginning before 1 January 2022
- Precluding intercompany transactions and asset transfers to an acquiring corporation in a Section 381(a) transfer from being treated as a "sale or other disposition"

The final regulations apply to the first tax year beginning 60 days after the final regulations are published in the Federal Register (i.e., 1 January 2021, for calendar-year taxpayers). An anti-avoidance rule applies to transactions entered on or after the date the final regulations are published in the Federal Register. Taxpayers may apply the final regulations to tax years beginning after 31 December 2017, so long as they consistently apply all of the final regulations.

The Section 163(j) proposed regulations:

- Include a substantially modified set of rules for applying the Section 163(j) Limitation to controlled foreign corporations (CFCs), including CFCs that are members of a "CFC group"
- Clarify the application of Section 163(j) to different partnership structures
- Provide guidance under the CARES Act on excess business interest expense allocated to a partner in a partnership in a 2019 tax year, and the election to use ATI from the last tax year beginning in 2019 to determine a taxpayer's Section 163(j) limitation for a 2020 tax year
- Provide rules for applying the Section 163(j) Limitation to foreign persons with effectively connected income

The proposed regulations generally are not retroactive, though taxpayers may choose to apply them to tax years beginning after 31 December 2017.

Section 965 transition tax

LB&I issues internal memo on Section 965 transition tax issues

The IRS Large Business and International (LB&I) Division on 17 November 2020 released a memorandum (LB&I-04-1120-0020) providing interim guidance for revenue agents and examiners regarding examinations with Section 965 transition tax issues. In particular, the memorandum provides guidance on the Section 965(k) six-year statute of limitations on assessment for returns with a Section 965 transition tax. The guidance does not cover returns that are subject to the centralized partnership audit regime under the *Bipartisan Budget Act of 2015* or TEFRA partnerships, which will be the subject of separate guidance.

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 election (see following article).

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 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 (JCT) 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.

Taxpayers need to consider international tax implications of making certain NOL elections under Revenue Procedure 2020-24, including Section 965 issues

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 for the 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, 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 officials elaborate on limited relief for Section 965 transition tax

A senior IRS official in early February 2020 provided further details on the January 2020 announcement by the Service offering limited relief from double taxation in regard to the Section 965 transition tax. (See the following article.)

The official was quoted as saying that taxpayers should not interpret the announcement as meaning that the IRS plans to issue more guidance in this area or planning to revisit positions already taken by the government in released guidance. The official also said the limited relief being offered should not be seen as an "alternative forum where relief is provided elsewhere," pointing to situations where competent authority relief is appropriate and available. Finally, the official said taxpayers should view the process as an informal inquiry, and not a formal process akin to a private letter ruling.

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 a result of E&P being taxed under Section 965 and as dividends or Section 956 inclusions should consider seeking relief.

Section 951A global intangible low-taxed income (GILTI)

Treasury and IRS finalize regulations to reduce possibility of double taxation caused by anti-abuse rules on GILTI gap period

Treasury and the IRS on 20 November 2020 issued final regulations (TD 9934) under Sections 245A and 951A that coordinate two independent sets of anti-abuse rules that apply to extraordinary dispositions and disqualified transfers (together, EDs). Both rules apply to certain transactions of a controlled foreign corporation occurring during the so-called Global Intangible Low-taxed Income (GILTI) gap period. Absent the final regulations, gain recognized in an ED effectively could be taxed twice. The final regulations, which come three months after the release of the proposed regs in August 2020, are effective 12 January 2021. The final regulations are substantially similar to the proposed regulations.

The final regulations can be applied retroactively, at the taxpayer's option. As a result, taxpayers may wish to file amended returns to mitigate negative consequences caused by the application of both sets of anti-abuse rules. In addition, taxpayers should evaluate whether the final regulations create opportunities to manage their overall tax liability, taking into account potential legislative and regulatory changes in the coming years, the taxpayer's attribute profile (including foreign tax credits), projections for future income and taxes, repatriation strategies, mergers and acquisitions, and numerous other unique considerations.

Notice 2020-69 provides rules on entity treatment election for certain S corporations for purposes of GILTI in AAA inclusions

In early September 2020, in Notice 2020-69, Treasury announced its intent to issue regulations addressing the application of subpart F and the Global Intangible Low-tax Income (GILTI) regime to certain S corporations with accumulated earnings and profits (AE&P) as of 1 September 2020. The Notice permits electing S corporations to apply its provisions to tax years of S corporations ending on or after 21 June 2019.

Key takeaways include:

- Notice 2020-69 provides an irrevocable election for an S corporation with "transition AE&P" as of 1 September 2020, to be treated as an entity for purposes of calculating an annual GILTI inclusion with respect to CFCs for which the S corporation is a US shareholder within the meaning of Section 951(b).
- As a result of this election, an S corporation will recognize the tested items of the CFCs with respect to which the S corporation is a US shareholder, calculate a GILTI inclusion and allocate to each shareholder a distributive share of this amount to include in taxable income. S corporation shareholders who are not US shareholders with respect to the corporation's CFCs must include their distributive share of GILTI calculated and allocated by the corporation.
- An electing S corporation's GILTI inclusion will result in a positive adjustment to the corporation's accumulated adjustments account.
- For tax years ending on or after 1 September 2020, the election is made by filing a statement with the corporation's timely filed original Form 1120S (including extensions). For tax years ending before 1 September 2020 and after 21 June 2019, the corporation and all of its shareholders must include a statement with a timely filed original return (including extensions) or on amended returns filed by 15 March 2021.

Treasury and the IRS propose complex, taxpayer-favorable regulations to reduce possibility of double taxation caused by anti-abuse rules during 'GILTI gap period'

Treasury and the IRS on 21 August 2020, released taxpayer-favorable proposed regulations under Sections 245A and 951A (REG-124737-19) to coordinate two independent sets of anti-abuse rules that apply to extraordinary dispositions and disqualified transfers (together, EDs). Both rules apply to certain transactions of a controlled foreign corporation (CFC) occurring during the so-called 'GILTI gap period.' Absent the proposed regulations, gain recognized in an ED effectively could be taxed twice:

- Once, in the form of a taxable dividend distributed by a CFC (because the dividend is deemed to be attributable to the ED)
- Twice, either as increased subpart F income or GILTI inclusions from a CFC (because deductions attributable to basis acquired in the ED may not reduce subpart F income or tested income) or as increased gain from transactions in CFC stock (because those deductions generally still reduce earnings and profits)

The proposed regulations contain numerous and complex rules, conditions, and exceptions. The regulations, which would not be elective, would coordinate the two sets of anti-abuse rules so that one set generally would not apply to the extent that the other set resulted in taxable income. Taxpayers may apply the proposed regulations before they are finalized, including retroactively to past tax years of foreign corporations.

Taxpayers that engaged in an ED should consider immediately how the proposed regulations apply to their circumstances. The regulations are complex and will entail significant compliance costs. In particular, a taxpayer in either of the following circumstances might benefit from taking action sooner than later:

- The ED rules have already applied to a dividend, such that the taxpayer has included marginal amounts in taxable income. The taxpayer might obtain a refund or credit upon amending past tax returns to apply the proposed regulations.
- The taxpayer intends, in the near future, to cause a specified foreign corporation to distribute a dividend to which the ED rules would apply. The taxpayer might accelerate that dividend so the disqualified basis anti-abuse rules' (DQB) reduction rule can increase CFC deductions in an earlier tax year, and those deductions are not otherwise lost forever.

Taxpayers should consider not merely the extent to which application of the proposed regulations would reduce, based on past tax years, their ED account balances and disqualified basis. They should also evaluate whether the proposed regulations create opportunities to manage those ED account balances and disqualified basis efficiently in future tax years. In so doing, taxpayers should take into account foreign tax credits and other attributes, projections for future income and taxes, repatriation strategies, mergers and acquisitions, and numerous other unique considerations.

The proposed regulations would apply to tax years of foreign corporations beginning on or after the proposed regulations' finalization, and to tax years of a United States person in which or with which those tax years end. For tax years beginning before the proposed regulations are finalized, however, taxpayers may apply the proposed regulations, provided they and all related parties apply the proposed regulations consistently to all such tax years.

Final and proposed GILTI regulations deliver few benefits and more than a few surprises

Treasury and the IRS issued final regulations (TD 9902) and proposed regulations (REG-127732-19) on 20 July 2020 (published in the Federal Register on 23 July 2020), addressing the application of the high-tax exclusions from Global Intangible Low-Taxed Income (GILTI) under Section 951A(c)(2)(A)(i)(II) (the GILTI high-tax exclusion) and from subpart F income under Section 954(b)(4) (the proposed subpart F high-tax exception), respectively.

The elective GILTI high-tax exclusion allows taxpayers to exclude from their GILTI inclusion items of a controlled foreign corporation's (CFC) gross tested income subject to a high effective rate of foreign tax.

This exclusion applies at the level of each "tested unit" of a CFC, which will lower the amount of gross tested income excluded from a taxpayer's GILTI inclusion.

The proposed subpart F income high-tax exception would conform that exception to the final GILTI high-tax exclusion. When finalized, a single election would be available to apply both the GILTI high-tax exclusion and the subpart F income high-tax exception.

More specifically, the final GILTI high-tax exclusion:

- Excludes from a CFC's gross tested income under Section 951A income items subject to an effective foreign tax rate over 18.9% (i.e., 90% of the highest corporate rate based on the current 21% corporate tax rate)
- Applies regardless of whether the CFC has tested income or a tested loss
- Applies at the level of each "tested unit" of a CFC, substantially eliminating blending of income subject to different rates of foreign tax
- Applies to every CFC in which a taxpayer holds, or is treated as holding, a majority equity interest (a CFC group)
- May be elected on an annual basis
- Applies generally for tax years beginning on or after 23 July 2020
- Permits taxpayers to apply the election retroactively to any CFC tax year beginning after 31 December 2017, if they apply the final regulations consistently to each year for which the election is made

The proposed regulations would conform the existing subpart F income high-tax exception to the GILTI high-tax exclusion and would apply a single unified election to both provisions (or neither) for a tax year. That is, the proposed regulations generally would:

- Incorporate the tested unit principles of the GILTI high-tax exclusion into the subpart F income high-tax exclusion
- Combine the GILTI high-tax election and the subpart F income high-tax election into a single election, requiring the election to apply simultaneously to *both* the GILTI and the subpart F income high-tax "exceptions," or to *neither*
- Conform generally to the rules governing the elections (including the requirement to apply the unified election to every CFC in a CFC group)

Many taxpayers will find the high effective foreign tax rate threshold adopted by the final regulations difficult to meet, especially as it applies to each tested unit of a CFC. Whether and the extent to which the exclusion reduces a taxpayer's GILTI inclusion, however, will require careful modeling – for current year (tax year 2019), future years, and also for previously filed tax years beginning after 2017.

The proposed regulations would replace the existing subpart F income high-tax exception and the newly-finalized GILTI high-tax exclusion with a unified high-tax exception. Many aspects of the proposed regulations were foreseeable (for example, the CFC group consistency rules and the tested unit standard). Yet the combination of the subpart F income high-tax exception and GILTI high-tax exclusion into a unified high-tax exception may surprise many taxpayers -particularly those that have applied the current high-tax exception in recent years.

Taxpayers should evaluate whether the unified high-tax exception is likely to be available, and advantageous, under the proposed regulations.

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

IRS 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.

Section 59A base erosion and anti-abuse tax (BEAT)

Final BEAT regulations adopt proposed BEAT guidance with some changes

On 2 September 2020, Treasury and the IRS released final regulations (T.D. 9910) on the base erosion and anti-abuse tax (BEAT) under Section 59A (2020 final BEAT regulations). The regulations finalize proposed BEAT regulations that were issued on 2 December 2019 (2019 proposed BEAT regulations), and revise certain final BEAT regulations issued on the same date (2019 final BEAT regulations). More specifically, the 2020 final BEAT regulations generally adopt the aggregate group rules, the election to waive deductions and the partnership rules of the 2019 proposed BEAT regulations.

The 2020 final BEAT regulations also provide generally taxpayer-favorable refinements to the nonrecognition transaction anti-abuse rule introduced by the 2019 final BEAT regulations.

Among the highlights, the final rules:

- Retain the rule about changes in the composition of a taxpayer's aggregate group and clarify the timing of the deemed tax year-end of a member joining or leaving the group (now treated as occurring at the end of the day of the transaction)
- Detail when members of a taxpayer's aggregate group have different tax years, including rules that apply in certain instances to annualize a member's gross receipts, base erosion tax benefits, and deductions for determining the gross receipts and base erosion percentage of the taxpayer's aggregate group
- Limit favorably the anti-abuse rule in certain circumstances for transactions that increase the basis of property acquired by a taxpayer in a non-recognition transaction
- Retain the definition of "allowed deduction," which includes all deductions that may properly be claimed (whether deducted or not) for the tax year, while also retaining the election to waive deductions so that waived deductions are not treated as base erosion tax benefits (e.g., when determining base erosion percentage or modified taxable income)
- Include, as part of the BEAT waiver election, a provision for the waiver of any premium or other consideration paid or accrued by a life or non-life insurance company for any reinsurance payments that would be a base erosion tax benefit

The final regulations also:

- Allow a partner, but not the partnership itself, to make a BEAT waiver election for allocated deductions from the partnership
- Conform the treatment of a partner's BEAT waiver election with Section 163(j) so that an increase in the partner's income from waiving a deduction taken into account by the partnership to reduce the partnership's adjusted taxable income is treated as a partner-basis item for the partner, not the partnership, for purposes of Section 163(j)
- Adopt the proposed rule treating an income allocation to the contributing partner in lieu of a deduction allocation to the non-contributing partner as a base erosion tax benefit under Section 59A

IRS will accept BEAT PLR requests

An IRS official in February 2020 was quoted as saying the Service will accept taxpayer requests for private letter rulings on determining the base erosion payment under the Section 59A Base Erosion and Anti-Abuse Tax (BEAT). The official added there is no timeline for the release of "informal" BEAT guidance such as chief counsel advice or a revenue ruling, something that had earlier been floated by the IRS as a possibility.

Final and proposed BEAT regulations were published in the Federal Register on 6 December 2019.

Section 250 FDII/GILTI deductions

Final FDII regulations retain proposed regulations' structure, but reduce documentation burden, defer effective date and make important substantive changes to computation of Section 250 deduction

Treasury and the IRS on 9 July 2020 released final regulations under Section 250 (TD 9901) for calculating the deduction allowed to a domestic corporation for its Foreign-Derived Intangible Income (FDII) and Global Intangible Low-Taxed Income (GILTI).

As background, Section 250 generally allows a domestic corporation an annual deduction in respect of its GILTI and FDII. For tax years beginning after 31 December 2017, but on or before 31 December 2025, the Section 250 deduction generally is the sum of: (i) 50% of the corporation's GILTI inclusion amount (and Section 78 "gross-up" for associated deemed-paid foreign income taxes) and (ii) 37.5% of its FDII.

If the sum of the taxpayer's GILTI and FDII amounts exceeds the taxpayer's taxable income, however, the Section 250 deduction is reduced, proportionately to those two amounts.

The final Section 250 regulations generally reflect a structure that is similar to the proposed regulations released in March 2019. Nevertheless, the final regulations contain a number of significant, and mostly taxpayer-favorable, changes. For example, the final regulations:

- Delay the effective date of the final regulations until tax years beginning in 2021
- Eliminate or relax, in response to taxpayer concerns, some of the more burdensome "documentation requirements" for "establishing" facts necessary to secure an FDII benefit
- Presume other necessary facts (e.g., foreign person, foreign use) in certain circumstances
- Allow taxpayers to use any "reasonable" method to coordinate Section 250 with other sections with taxable income limitations (e.g., Sections 163(j) and 172)
- Require taxpayers to ignore carryover deductions under those sections when identifying deductions to be apportioned to gross deduction eligible income (DEI) and gross foreign-derived deduction eligible income (FDDEI)
- Relax certain provisions that defer an FDII benefit for a related-party sale that is followed by an unrelated-party sale
- Introduce new provisions applicable to narrower categories of taxpayers (e.g., "digital content" and SaaS providers, providers of advertising services, *Arms Export Control Act* sellers and renderers, and taxpayers engaging in hedging transactions)

Most taxpayers will find the final Section 250 regulations — as compared to the proposed regulations — to be quite favorable. In particular, the final regulations adopt sensible rules for taxpayers to document their FDDEI sales and services.

The final regulations are more accommodating in other respects as well. Most importantly, the effective date of the final regulations has been postponed to tax years beginning on or after 1 January 2021, giving taxpayers more time to develop systems or other procedures to meet the substantiation requirement; for tax years before that effective date, taxpayers may apply, at their option, the final or the proposed regulations (subject to consistency requirements).

Taxpayers should also consider whether a desired position for a pre-2021 tax year may be taken based solely on a reasonable interpretation of Section 250 itself.

Nearly every taxpayer should now react swiftly to the final regulations. For tax years beginning before 1 January 2021, taxpayers should consider which set of regulations would be more favorable — or less burdensome — to them. Looking forward, taxpayers ought to model the effect of various reasonable methods to coordinate the taxable income limitations of Sections 250(a)(2), 163(j), 172 and others.

Moreover, taxpayers should evaluate the new documentation requirements and substantive provisions against their facts and begin the process of reassessing their operating models, intercompany flows, and pricing policies and consider whether changes should be made to take full advantage of the benefits under Section 250.

Section 245A dividends received deduction

Treasury and IRS finalize DRD anti-abuse regulations with few changes

On 21 August 2020, Treasury and the IRS released final regulations under Section 245A (TD 9909) providing anti-abuse rules for "extraordinary dispositions" and "extraordinary reductions." The regulations finalize proposed regulations and replace temporary regulations that were issued in June 2019.

The final regulations continue to deny the Section 245A dividends received deduction (DRD) for 50% of the dividends paid by specified 10%-owned foreign corporations (SFCs) to the extent attributable to earnings and profits (E&P) from extraordinary dispositions. Similarly, the final regulations continue to deny 100% of the Section 245A DRD for certain dividends paid in a tax year in which an extraordinary reduction occurs.

The final regulations are substantially similar to the proposed and temporary regulations, with a limited number of generally taxpayer-favorable changes at the margin. While the substantive rules did not change much, taxpayers should pay close attention to new examples illustrating anti-abuse rules. Several new examples illustrate the anti-abuse rules, and one of them would extend the application of the extraordinary-disposition rules beyond "dispositions."

At the same time, Treasury and the IRS released new proposed regulations that would coordinate the final regulations with certain rules under Section 951A that effectively deny deductions arising from "disqualified basis" that is generated during the 'GILTI gap period,' as defined later. (See TCJA – Section 951A.)

The final regulations apply to tax periods ending on or after 14 June 2019, while Temp. Reg. Section 1.245A-5T continues to apply to distributions made after 31 December 2017, to which the final regulations do not apply. Taxpayers may apply the final regulations retroactively, provided that they and all related parties apply them consistently.

Section 267A/245A hybrid mismatches

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 2020 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.

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.

Section 958(b)(4) repeal

IRS releases final and proposed regulations related to the repeal of Section 958(b)(4)

On 21 September 2020, Treasury and the IRS released final regulations (TD 9908) and proposed regulations (REG-110059-20) relating to the repeal of Section 958(b)(4) by the *Tax Cuts and Jobs Act* (TCJA). Before the repeal by the TCJA, Section 958(b)(4) prevented a US subsidiary from being treated as owning stock in a foreign-owned brother-sister subsidiary for purposes of determining whether the brother-sister foreign subsidiary was a CFC.

The regulations do not undo the repeal of Section 958(b)(4). Instead, the regulations modify certain provisions to apply in a manner consistent with their application before the repeal of Section 958(b)(4). The final regulations generally adopt the proposed regulations that were issued on 2 October 2019.

The final regulations provide welcome relief for certain provisions (e.g., limiting the application of Section 267(a)(3)(B) to the deduction for an accrued amount that is income of a CFC with a US inclusion shareholder) to continue to apply in a manner favorable to taxpayers in light of Section 958(b)(4) repeal.

But the final regulations are balanced by modifying other provisions (e.g., a liquidation of an applicable holding company to a foreign corporation under Section 332) to prevent a result inconsistent to that prior to the repeal of Section 958(b)(4). Notably, the final regulations, citing a lack of statutory and regulatory authority, decline to provide rules mitigating the adverse impact of Section 958(b)(4) repeal on limiting the exemption from US withholding tax on certain interest paid by a US person to a related foreign corporation that is a CFC because of Section 958(b)(4) repeal.

The new proposed regulations would modify the application of Section 954(c)(6) and certain rules under Section 367(a) to take into account the repeal of Section 958(b)(4). Notably, in the case of Section 954(c)(6), the proposed regulations would deny look-through treatment for dividends, interest, rents and royalties received by a CFC from a foreign corporation that is a CFC as a result of the repeal of Section 958(b)(4).

The final regulations generally apply to tax years of a foreign corporation ending on or after 1 October 2019 (or to relevant transfers or payments made or accrued on or after 1 October 2019). However, taxpayers may generally apply the final regulations to the last tax year of a foreign corporation beginning before 1 January 2018, and each subsequent year of the foreign corporation (prior to the first tax year that is subject to the final regulations), provided that the taxpayer and US persons that are related (within the meaning of Sections 267 or 707) consistently apply the relevant rule with respect to all foreign corporations.

The denial of Section 954(c)(6) look-through treatment is proposed to apply to payments of dividends, interest, rents and royalties made during tax years of the foreign corporation ending on or after 21 September 2020. The retroactive effect of the proposed rule to apply to amounts paid or accrued by a foreign corporation for tax years of the foreign corporation ending on or after 21 September 2020, is somewhat of a surprise and taxpayers should carefully assess the Section 954(c)(6) treatment of payments received by a CFC from a related foreign corporation that have already occurred (e.g., before 21 September 2020, for a tax year ending on 31 December 2020) in light of the proposed rule.

The proposed regulation under Section 954(c)(6) would also apply to tax years of a foreign corporation ending before 21 September 2020, resulting from an entity classification election or a change in tax year under Section 898 with respect to the foreign corporation that was effective on or before 21 September 2020, but filed on or after that date.

The proposed regulations under Section 367(a) would apply to transfers occurring on or after 21 September 2020. Taxpayers may also rely on the proposed regulations for tax years before the date the regulations are finalized, provided that the taxpayer (and related persons under Sections 267 or 707) consistently rely on the relevant proposed regulation with respect to all foreign corporations.

Section 1446(f) withholding

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 interests in 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.

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.

Major policy changes in a coming Biden Administration

Joe Biden was certified as the President-elect by the Electoral College on 14 December 2020.

Tax, healthcare, immigration and climate policy are key areas where a Biden Administration likely will diverge significantly from the Trump Administration.

Although candidate Biden had previously signaled that tax increase plans would be implemented on "Day 1," it now appears that such plans may wait until after the coronavirus and its effects are addressed.

On taxes, Biden has said he would raise the top corporate income tax rate to 28% from 21%. He also proposed taxing capital gains and dividends as ordinary income for those with annual incomes of more than $1 million and setting a 15% minimum tax on the book income of corporations with book income greater than $100 million. These changes are proposed to pay for increased spending on infrastructure, healthcare, education and the environment, not to reduce the debt or deficit.

In regard to international tax, Biden indicated he supports measures that would discourage off-shoring and encourage on-shoring. To that end, Biden has proposed increasing the tax rate on profits earned by foreign subsidiaries of US firms by increasing the global intangible low-taxed income (GILTI) tax rate to 21% and applying the regime on a per-country basis. He has also proposed creating a "Made in America" tax credit to offset 10% of investments geared toward creating jobs in the US and introducing a surtax on certain goods and services imported into the US.

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.

President Trump signs interim coronavirus relief measure

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 provided $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.

CARES Act stimulus package has international tax implications

President Trump on 27 March 2020 signed into law the $2.2 trillion bipartisan *Coronavirus Aid, Relief, and Economic Security* (CARES) *Act* (H.R. 748), which was passed by the House earlier that day and by the Senate on 25 March. The legislation capped many days of around-the-clock negotiations between congressional leaders and the Administration and was the third coronavirus bill to be passed by Congress in a span of several weeks.

President Trump earlier in March signed into law the second coronavirus response bill, the *Families First Coronavirus Response Act* (H.R. 6201), a package of measures to address initial hardships as a result of the pandemic. The first such legislation was a coronavirus appropriations bill, H.R. 6074.

The CARES Act provided for loans and other benefits to businesses small and large, expanded unemployment insurance, directed payments to those with wages middle-income and below, provided new appropriations funding for health care and other priorities. The legislation also included tax changes like deferrals of employer payroll tax liabilities coupled with an employee retention tax credit and rollbacks of *Tax Cuts and Jobs Act* (TCJA) limitations on net operating losses (NOLs) and the Section 163(j) business interest limitation.

Importantly, the final bill did not include several earlier proposals that were included in a prior Senate Republican draft of the bill, for example, narrowing the application of downward attribution of stock ownership.

The CARES Act included eight business tax provisions aimed at providing liquidity through:

- Crediting against employers' payroll taxes amounts paid in wages to retained workers
- Delaying payment of employer payroll taxes
- Allowing a five-year carryback period for NOLs and temporarily removing the 80% limitation on the use of NOLs
- Allowing NOL relief for noncorporate businesses
- Clarifying AMT refund allowances
- Increasing the allowance for business interest deductions
- Adding a technical correction for qualified improvement property under Section 199A that was enacted by the TCJA
- Excepting temporarily from alcohol excise taxes businesses that convert to producing hand sanitizers

Several of the enacted provisions have major implications for multinational corporations.

Changes to NOL rules under Section 172(a)

The CARES Act temporarily suspends the 80% taxable income limitation on the use of a net operating loss to offset taxable income for tax years beginning after 31 December 2017 and before 1 January 2021. Taxpayers may elect to:

- Carry NOLs arising in any tax year beginning after 31 December 2017 and before 1 January 2021, back five years
- Exclude a Section 965 transition tax year from the five-year NOL carryback period

Taxpayers may not use the NOL carryback to directly reduce the amount of Section 965 transition tax incurred in a transition year. Taxpayers may still carry NOLs forward if they decide against carrying them back.

The carryback or carryforward of an NOL may affect a taxpayer's: (1) allowable Section 250 deduction (both against Foreign-derived Intangible Income (FDII) and Global Intangible Low-taxed Income (GILTI)); (2) allowable foreign tax credits (FTCs); (3) Base Erosion and Anti-abuse Tax (BEAT) liability; and (4) in some cases, the taxpayer's Section 965 transition tax liability.

Temporary changes to Section 163(j) limitation

The CARES Act generally allows taxpayers to increase the 30% of adjusted taxable income (ATI) limitation on business interest expense to 50% of ATI for any tax year beginning in 2019 or 2020. Taxpayers may elect not to apply the higher 50% limitation. Taxpayers may also elect to use their 2019 ATI (in lieu of 2020 ATI) in their 2020 tax year to calculate their 2020 Section 163(j) limitation. If the additional deduction yields negative tax consequences for another tax provision, such as Section 59A (BEAT), taxpayers may decide not to elect to apply the increased Section 163(j) limitation.

For tax year 2019, partnerships must use the 30% of ATI limitation. The ATI limitation increases to 50% of ATI for partnerships in their 2020 tax years, unless the partnership elects not to apply the higher limitation. The partnership may elect to substitute tax year 2019 ATI for tax year 2020 ATI.

Partners may treat 50% of any excess business interest expense (EBIE) allocated to them from a partnership in tax year 2019 as automatically paid or accrued to them in the partner's 2020 tax year, without further Section 163(j) limitations at the partner level (i.e., the partner can deduct that 50% portion regardless of the partner's ATI). The remaining 50% of 2019 EBIE is subject to the "normal" testing rules for EBIE at the partner level (i.e., the partner needs to receive an allocation of excess taxable income (ETI) from that same partnership in future tax years to potentially free up those amounts). The partner may elect not to apply this special rule.

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The modification to the NOL carryback rules may yield a cash benefit to taxpayers that can use their NOLs. There may, however, be some unanticipated international tax consequences arising from the interaction of modified Section 172(a) with other IRC provisions.

Section 965 transition tax: Carrying an NOL to a pre-transition tax year does not directly impact the amount of a taxpayer's transition tax inclusion. However, the NOL deduction claimed in that carryback year could increase the taxpayer's FTC carryover from that year. The FTC carryover would need to be taken into account in each succeeding tax year under Section 904(c), and a greater FTC carryover could be available in the Section 965 transition tax year (whether 2017 or 2018), thus reducing the taxpayer's transition tax liability.

Section 250 deduction: The CARES Act does not amend the taxable income limitation in Section 250(a)(2), which otherwise reduces the allowable Section 250(a)(1) deduction when the sum of a taxpayer's FDII and GILTI exceeds its taxable income for the year (without regard to Section 250). Effectively, the Section 250(a)(2) limitation may result in taxpayers utilizing a 21% tax attribute (an NOL deduction) against items of income (FDII and GILTI), subject to a lower rate of tax because of the Section 250 deduction.

Foreign tax credit limitation: A greater NOL deduction will reduce a taxpayer's FTC limitation under Section 904, whether the NOL source is foreign or domestic. As previously noted, a taxpayer will generally have a greater FTC carryforward coming out of the NOL carryback year. A domestic-source NOL may create, or increase, an overall domestic loss (ODL) account, which may be beneficial in a subsequent tax year. An ODL account from a pre-*Tax Cuts and Jobs Act* tax year would be subject to the transition rules included in the final FTC regulations (TD 9882). A foreign-source NOL may create, or increase, a separate limitation loss or an overall foreign loss account, which could be detrimental in a subsequent tax year, including in the Section 965 transition tax year. The transition rules in TD 9882 would apply to this account when transitioning from a pre-TCJA tax year to a post-TCJA tax year.

Taxpayers should also consider the tax rate differential between pre-TCJA and post-TCJA tax years. Generally, FTCs carried to pre-TCJA years offset income taxed at 35%, while FTCs utilized in a post-TCJA year will offset income taxed at a maximum 21% rate.

BEAT liability: An NOL carryback to a tax year for which Section 59A is effective could create or increase a taxpayer's BEAT liability. Simply stated, an NOL deduction reduces a taxpayer's regular tax liability, which can create or increase the taxpayer's base erosion minimum tax amount. As a result, a taxpayer that is an applicable taxpayer, as defined for BEAT purposes, and that elects to carry back an NOL may be subject to a BEAT liability depending on its adjusted regular tax liability in the carryback year. This will likely come as a surprise to many taxpayers.

Tax Administration

IRS LB&I official offers insights to TCJA compliance campaign

A senior official in the IRS Large Business and International Division in June 2020, provided more details with regard to the recently announced *Tax Cuts and Jobs Act* (TCJA) compliance campaign. The official distinguished the new TCJA campaign from others by saying it will not focus on specific transactions or issues. Rather he was quoted as saying IRS examiners would be reviewing taxpayers' entire returns to "develop a base-level of understanding of the *Tax Cuts and Jobs Act* to bridge from where we are to where we want to be with our employees."

The campaign exams reportedly was set to begin soon after the IRS suspension of compliance action ended on 15 July 2020.

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 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.

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. Consistent with the intent of the CARES Act to increase liquidity by getting cash into taxpayers' hands, the IRS 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.

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.

IRS expands 15 April tax relief and issues FAQs on extension of filing and payment deadlines

In response to COVID-19, the IRS in Notice 2020-18 extended until 15 July 2020, the 15 April due date for filing federal income tax returns. Notice 2020-18 also removed the previously imposed caps on the payment amount that could be postponed so that taxpayers had until 15 July to pay their entire tax liability without incurring penalties or interest.

Notice 2020-18 superseded Notice 2020-17, issued on 18 March 2020, in which the IRS postponed the 15 April payment deadline until 15 July and imposed certain caps on the amounts subject to relief.)

The IRS on 24 March also posted Frequently Asked Questions (FAQs) on the extension of certain filing and payment deadlines to 15 July 2020 provided in Notice 2020-18.

The FAQs indicated, among other things, that for any taxpayer whose Federal income tax return filing due date had been postponed from 15 April to 15 July 2020, the due date of that taxpayer's Section 965 installment payment was also postponed to 15 July 2020.

Similarly, for any taxpayer whose Federal income tax return filing deadline was postponed from 15 April to 15 July 2020, the due date for Form 8991 and the Base Erosion Anti-Abuse Tax (BEAT) payment was postponed to 15 July 2020. The relief provided by Notice 2020-18 did not generally apply to the filing of information returns (see Rev. Proc. 2018-58, which explains the impact on other filings, etc., from a postponement to file under Section 7805A (which is the authority for Notice 2020-18)).

IRS announces COVID-19 information webpage

The IRS in March 2020 announced a new webpage (https://www.irs.gov/coronavirus) that consolidates information intended to help taxpayers affected by the coronavirus.

Foreign tax credit

Treasury releases final and new proposed foreign tax credit regulations

Treasury and the IRS on 29 September 2020 released final regulations (T.D. 9922; Final Regulations) and new proposed regulations (REG-101657-20; Proposed Regulations) on determining the foreign tax credit, and allocating and apportioning deductions, for US federal income tax purposes. The Final Regulations generally follow proposed regulations published on 2 December 2019, but make certain changes.

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, includes 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
- Transfer pricing

Highlights of the Final Regulations include provisions that:

- Allocate and apportion foreign income taxes to gross income under Reg. Section 1.861-20, including for purposes of categorizing taxes to separate Section 904(d) categories, by:
  - Allocating taxes on foreign income items with no corresponding US income item
  - Identifying an exclusive list of "base differences" (for which a foreign tax credit under Section 960 is effectively denied) that no longer includes foreign law distributions treated as a return of basis for US federal income tax purposes
  - Describing the treatment of (regarded) distributions
- Retain mandatory sales-based apportionment of research and experimentation (R&E) expense to all gross intangible income related to the relevant product SIC code, specifically excluding Global Intangible Low-Taxed Income (GILTI), subpart F inclusions and dividends
- Provide that exclusive apportionment of R&E expense does not apply for purposes of computing Foreign-Derived Intangible Income (FDII)
- Clarify that stewardship expenses are allocated to domestic and foreign dividends, GILTI, and subpart F inclusions, and apportioned based on the value of the domestic and foreign stock
- Add an election under Section 905(c) to account for certain foreign tax redeterminations of a CFC for pre-2018 tax years as if they occurred in the CFC's last tax year beginning before 1 January 2018
- Reduce hybrid deduction accounts under Section 245A(e) by reason of certain subpart F income and GILTI, and provide guidance on the treatment of certain stock as a financing transaction under the conduit financing rules of Reg. Section 1.881-3

Notable provisions of the Proposed Regulations would:

- Fundamentally overhaul the creditability requirements of a foreign income tax under Sections 901 and 903 by requiring jurisdictional nexus for the tax to be creditable (without considering the location of customers or users as a significant factor)
- Introduce new rules under Reg. Section 1.861-20 for allocating and apportioning foreign income taxes imposed on (i) dispositions of stock and partnership interests, and (ii) disregarded payments made between "taxable units" that generally would categorize foreign taxes based on the income of the payor making the disregarded payment
- Disallow foreign tax credits and deny deductions under Section 245A(d) for foreign income taxes attributable to any dividend for which a deduction under Section 245A would be allowed
- Add an election to capitalize and amortize R&E and advertising expenditures for purposes of apportioning interest expense under Reg. Section 1.861-9
- Treat, for purposes of computing the Section 250 FDII deduction, services as electronically supplied services if the value of the service to the end user is derived primarily from the service's automation or electronic delivery, as opposed to human effort (e.g., legal, accounting, medical, or teaching services)

IRS issues final Section 901(m) regulations

On 20 March 2020, Treasury and the IRS published final regulations providing guidance on determining the creditability of foreign taxes following covered asset acquisitions (CAAs) under Section 901(m). The final regulations are generally consistent with the prior temporary regulations and the proposed regulations published in December 2016.

Among other things, the final regulations include the three additional categories of transactions treated as covered asset acquisitions contained in the proposed regulations. Importantly, the final regulations modify various definitions to effectively exempt CAAs, to the extent gains and losses with respect to the relevant foreign assets are recognized by members of the domestic Section 901(m) payor or a member of the same consolidated group as the Section 901(m) payor. The final regulations further clarify that Section 901(m) calculations should be made prior to the application of Section 909 in the case of CAAs involving foreign tax credit splitters.

The finalized proposed regulations generally apply to CAAs occurring on or after the date the final regulations were published in the Federal Register.

Corporate

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.

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.

Partnerships

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) released in mid-October 2020, the government 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 issues final regulations on characterization of foreign persons' gain or loss from sale/exchange of interests in partnerships engaged in a US trade or business

Treasury and the IRS on 21 September 2020 released final regulations (T.D. 9919) under Section 864(c)(8) that provide guidance for determining the treatment of gain or loss recognized by a foreign person on the sale of an interest in a partnership that is engaged in the conduct of a trade or business within the United States (US trade or business). The final regulations largely adopt proposed regulations that were issued on 20 December 2018 (REG-113604-08), with certain modifications.

The final regulations generally retain the proposed regulations' three-step approach for determining effectively connected gain or loss in part by reference to a "deemed sale" of the partnership's assets. However, the final regulations adopt favorable "asset-specific rules" for determining, by reference to existing sourcing rules, the foreign-source portion of gain or loss on the deemed sale of the partnership's assets. The final regulations also clarify the application of the deemed sale rule to assets that would be exempt from US. tax under an applicable US income tax treaty if disposed by a partnership.

The final regulations do not, however, provide withholding and reporting guidance. On 13 May 2019, the Treasury and the IRS published proposed regulations (REG-105476-18) in the Federal Register relating to the withholding of tax and information reporting with respect to dispositions of an interest in a partnership. Although those proposed regulations were not finalized in connection with the final regulations under Section 864(c)(8) as expected, the government indicated that they plan to publish final withholding and information reporting regulations in a later issue of the Federal Register.

The final regulations apply to transfers occurring on or after 26 December 2018. Although the final regulations are not applicable to transfers occurring before 26 December 2018, Section 864(c)(8) is self-executing, such that all transfers occurring on or after 27 November 2017, but before 26 December 2018, are subject to Section 864(c)(8). Amounts taken into account on or after 26 December 2018 pursuant to an installment sale are subject to the final regulations.

Section 864(c)(8) has broad applicability. In addition to sales of partnership interests, Section 864(c)(8) may apply to redemptions of a partner's interest, distributions in excess of basis, and a rebalancing of partnership interests in which Section 731(a) gain or loss is recognized. In many cases, foreign partners and partnerships in which they invest are surprised by the variety of circumstances under which compliance with Section 864(c)(8) may be necessary.

Furthermore, the final regulations do not include final reporting rules that would require a partnership to provide information to a foreign transferor regarding its distributive share of any deemed sale gain or loss. In the absence of applicable reporting requirements, it is often challenging for a foreign transferor to determine its liability under Section 864(c)(8). However, the preamble to the final regulations indicates that Treasury and the IRS expect to finalize regulations including these reporting rules in the future.

Partnerships that are engaged in a US trade or business should be prepared to implement those rules, which can require the determination of deemed sale effectively connected gain or deemed sale effectively connected loss by a partnership on any date in which a foreign transferor (including an indirect foreign transferor in an upper-tier partnership) transfers its partnership interest.

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

On 17 January 2020 Treasury and the IRS released final regulations (TD 9891) under Section 721(c) that deny nonrecognition treatment to contributions of appreciated property by US persons to certain partnerships with related foreign partners. Section 721(c) provides 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 a particular method for allocating tax and book items relating to the contributed property (the remedial allocation method) and meets certain other requirements. Temporary regulations under Section 721(c) had been published in January 2017, and the final regulations adopted in most respects the provisions of those regulations (with a few notable changes and clarifications). The final regulations, effective 17 January 2020, generally apply to contributions occurring on or after 6 August 2015 (the effective date of Notice 2015-54, the notice that originally announced these regulations).

Capital markets

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

In mid-October 2020, 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.

No prohibition against PLRs on virtual currency transactions

An IRS official in November 2020 was quoted as saying that there is no overall policy against issuing private letter rulings in regard to the tax treatment of virtual currency transactions, noting that the IRS addresses issues on a case-by-case basis. The official added that while summary statistics for 2019 are not yet in, the Government has seen a "steady increase in income and gain reported for taxpayers' virtual currency transactions" for tax years 2013 through 2018.

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.

IRS delays certain Section 987 foreign currency regulations for additional year

Treasury and the IRS on 17 September 2020 announced (Notice 2020-73) their intent to amend the final Section 987 regulations issued in 2016 (T.D. 9794, the 2016 Final Regulations), as well as certain related final regulations issued in 2019 (T.D. 9857, the 2019 Final Regulations), to further delay their applicability date by one additional year. Consequently, these regulations will now apply to tax years beginning after 7 December 2021 (e.g., to 2022 for calendar-year taxpayers).

Consistent with Notice 2019-65, the applicability date of Reg. Section 1.987-12 was not changed, so the deferral event and outbound loss event rules of Reg. Section 1.987-12 generally apply to events occurring on or after 6 January 2017.

As noted by Treasury and the IRS, the related 2016 temporary regulations expired on 6 December 2019, and the proposed regulations that were not finalized in 2019 remain outstanding.

Taxpayers may rely on the provisions of Notice 2020-73 before amendments to the final regulations are issued. Taxpayers may also choose to apply the 2016 Final Regulations, the related temporary regulations (until they were revoked or expired, as applicable), and the related 2019 Final Regulations (beginning on 13 May 2019) to tax years beginning after 7 December 2016, and before 8 December 2021, provided the taxpayer and its related parties consistently apply those regulations to such tax years.

Although the temporary regulations have expired, the Notice indicates that taxpayers can rely on certain provisions of the proposed regulations, provided the taxpayer and its related parties consistently follow the proposed regulations in their entirety and apply the 2016 Final Regulations and the related 2019 Final Regulations for the same tax year.

A taxpayer may rely on the annual deemed termination election provisions of the proposed regulations, provided that the taxpayer and its related parties consistently follow those proposed regulations in their entirety. Additionally, taxpayers may rely on Reg. Sections 1.987-7 (Section 987 aggregate partnerships) and 1.988-2(b)(16) (deferral of loss on certain related-party debt instruments) of the proposed regulations, provided that the taxpayer and its related parties consistently follow each Section of those proposed regulations.

Although the deferral was expected, the new guidance should be a welcome relief for taxpayers, as the delayed applicability date provides additional time for taxpayers to create and implement the complex systems and processes necessary to transition to the Section 987 Final Regulations. Unfortunately, unlike prior deferral notices, Notice 2020-73 does not indicate that the IRS is considering changes to simplify the regulations.

Until the final regulations are effective, taxpayers must compute Section 987 gain or loss under a reasonable method and must also use the deferral or outbound loss event rules of Reg. Section 1.987-12, which currently apply. Additionally, taxpayers need to consider that Section 987 gain or loss affects taxable income, which in turn affects other provisions, such as the limitation on interest expense under Section 163(j), the Base Erosion and Anti-abuse Tax (BEAT) under Section 59A, calculations of Global Intangible Low-taxed Income under Section 951A, the subpart F income rules under Section 951, and the foreign-branch income-basket rules under Section 904(d).

Passive Foreign Investment Company (PFIC)

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) released in December 2020, 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.

Sourcing

Treasury issues final sourcing regulations on sales of personal property (including inventory)

The government on 29 September 2020 released final regulations (TD 9921) (the Final Regulations) with rules for determining the source of income from sales of inventory produced within the United States and sold outside the United States, or vice versa. The Final Regulations further include rules for determining whether foreign-source income is effectively connected with the conduct of a US trade or business. Additional rules address the sourcing of a nonresident's income from certain sales of personal property that are attributable to an office maintained in the United States.

The Final Regulations generally follow the proposed regulations issued on 30 December 2019 (REG-100956-19), with certain changes. In particular, the Final Regulations:

- Require taxpayers electing to use the books-and-records method for apportioning gross income between sales and production activities under Reg. Section 1.865-3(d) to use that method for 48 months unless the IRS consents to the election's revocation
- Clarify that the adjusted basis of production assets (used to source income when production occurs both within and outside the United States) is determined by averaging the assets' bases at the beginning and end of the year, unless a change occurred during the year that would materially distort the calculation
- Modify the rules for determining whether a taxpayer's activities constitute production activity by referring to the rules for foreign base company sales income in Reg. Section 1.954-3(a)(4), but without applying the "substantial contribution" rules
- Do not expand the rules for determining the location of production activity to include activities or assets of related parties or unrelated agents
- Modify the anti-abuse rule in Reg. Section 1.863-3(c), and add an example illustrating that the rule may apply to certain acquisitions of domestic production assets by related partnerships (or their subsidiaries) if the acquisition has a principal purpose of reducing Reg. Section 1.863-3 tax liability by treating inventory sales income as subject to Section 862(a)(6) rather than Section 863(b)

The Final Regulations generally apply to tax years ending on or after 23 December 2019. Taxpayers may choose to apply the Final Regulations in their entirety for any tax year beginning after 31 December 2017, if they and all related persons continue to apply the regulations for all subsequent years.

Foreign Investment in Real Property Tax Act (FIRPTA)

TIGTA finds major FIRPTA withholding discrepancies

The Treasury Inspector General for Tax Administration (TIGTA) in March 2020 released a report entitled "Millions of Dollars in Discrepancies in Tax Withholding Required by the *Foreign Investment in Real Property Tax Act* Are Not Being Identified or Addressed"—and reaching that conclusion. The Act (FIRPTA) generally imposes US federal income tax on any foreign person selling a US real property interest. FIRPTA requires the purchaser in such a sale to withhold from the purchase proceeds a percentage of the seller's amount realized from the sale. If the withheld amount exceeds the tax that the seller actually owes, the seller can file the appropriate US federal income tax return claim a refund or credit for the excess. TIGTA's review was meant to assess IRS efforts to verify the accuracy of withholding overages claimed on those seller returns. Comparing pairs of IRS forms relating to the same sale, TIGTA found discrepancies totaling more than $688 million and made numerous recommendations for corrective action. The IRS agreed to all of TIGTA's recommendations (though the IRS indicated it believed TIGTA's totals overstated the discrepancies).

Tax treaties

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.

US, Swiss competent authorities reach agreement on treaty arbitration process

The IRS in late August 2020 (Announcement 2020-13) disclosed that the US and Swiss competent authorities entered into an agreement establishing a competent authority arrangement regarding implementation of the arbitration process in Article 25, paragraphs 6 and 7, of the US-Switzerland income tax treaty.

According to the treaty, arbitration will be available where, pursuant to the Article 25 mutual agreement procedure, the competent authorities are unable to reach a complete agreement. In addition, an unresolved competent authority request that originated in a bilateral Advance Pricing Agreement request will be subject to arbitration procedures. Certain cases described in the competent authority arrangement are not eligible for arbitration.

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

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 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. (The USMCA entered into force on 1 July 2020.)

Now that the USMCA has entered into force and replaced 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.

IRS notes more multilateral APA requests

The Director of the IRS Advance Pricing and Mutual Agreement (APMA) program in July 2020 was quoted as saying there has been an uptick in multilateral advance pricing agreement (APA) requests. The official also said that multilateral APAs are representing a broader range of transactions and not limited to specific global financial transactions as in the past. The APMA Director noted that the IRS is seeing more multilateral APA requests that include a "sandwiched" foreign-owned US entity involving related transactions with the foreign parent and other foreign subsidiaries.

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.

Transfer pricing

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."

US, Mexico renew competent authority agreement on unilateral APAs for maquiladoras

The IRS announced on 16 November 2020 that it has reached an agreement with the Mexican Tax Authority (SAT) to renew the competent authority agreement arrangement known as the Qualified Maquiladora Approach Agreement (QMA). Under the QMA, a US taxpayer can avoid double taxation on its maquiladora contract manufacturing and assembly functions by entering into a unilateral advance pricing agreement (APA) with SAT's large taxpayer division under terms agreed in advance by the US and Mexican competent authorities.

The US and Mexican competent authorities last negotiated a QMA agreement in 2016. The 2016 QMA updated and expanded a 1999 agreement between the US and Mexican competent authorities on transfer pricing and other aspects of the tax treatment of maquiladoras of US multinational enterprises. The 2016 QMA included changes reflecting revisions to Mexican domestic transfer pricing rules, documentation requirements and other tax attributes of maquiladoras.

The 2020 renewal agreement follows the framework of the 2016 QMA, which the competent authorities agree has continued to work to produce arm's-length results. The 2020 renewal agreement adds several new features, however. Specifically, the 2020 agreement adds a mechanism for addressing situations in which the maquiladora has an outstanding accounts-receivable balance that the competent authorities agree is inconsistent with the transfer pricing profile of the Mexican entity.

The 2020 QMA covers tax years through 2019 and commits the competent authorities to continue collaborating on another renewal for tax years 2020 and beyond. The competent authorities intend discussions on future agreements to consider the impacts of current economic, commercial and public health conditions affecting taxpayers.

Over 700 US taxpayers with maquiladoras are expected to qualify for the QMA. SAT will directly notify qualifying Mexican taxpayers, and such notifications will include details on necessary steps for taxpayers with pending unilateral APA requests. Taxpayers can also reach out to the IRS Advance Pricing and Mutual Agreement program with questions regarding whether the QMA or a bilateral APA would be more appropriate for its facts and circumstances.

IRS updates list of jurisdictions for automatic exchange of CbC reports

In mid-November 2020, the IRS updated the website that includes a listing of the jurisdictions with which the US Competent Authority has entered into a Competent Authority Agreement (CAA) for the automatic exchange of Country-by-Country (CbC) reports and the jurisdictions that are in negotiations for a CAA.

Most recently, the IRS added Singapore to the list of countries with which the US has signed a CAA for the automatic exchange of CbC reports. The US Competent Authority also released a joint statement with the French Competent Authority, explaining that France is negotiating a CAA with the US to allow for the automatic exchange of CbC reports. The Joint Statement indicates that with respect to fiscal years of multinational enterprise groups commencing on or after 1 January 2019 and before 1 January 2020, the Competent Authorities intend to spontaneously exchange CbC reports.

IRS planning new guidance on stock-based compensation in cost-sharing context

A senior IRS official in November 2020 was quoted as saying that the Government is working on new guidance related to stock-based compensation in relation to cost sharing arrangements that will address the *Altera v. Commissioner* decision. The guidance reportedly will cover the effects of sharing stock-based compensation on the calculation of the buy-in payment or platform contribution transaction, entity-level effects, the timing of an inclusion, and the impact of the *Tax Cut and Jobs Act's* Section 965 transition tax and GILTI provisions. The official indicated the guidance is a high priority and said that "hopefully we're able to get something out at some point relatively soon."

Although *Altera* is only effective in areas within the Ninth Circuit's purview, IRS officials believe the "case will help the Service and the government and availing in other circuits," with one goal being to avoid a split in the circuits.

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.

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.

US Supreme Court declines to hear *Altera* case

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 (2003 regulations), which requires participants to include stock-based compensation costs in a cost-sharing arrangement. The denial to hear the case puts an end to Altera's Ninth Circuit stock-based compensation challenge.

As background, on 27 July 2015, the Tax Court ruled that the 2003 regulations were invalid under the *Administrative Procedure Act*. The Tax Court found that Treasury's conclusion that the final rule was consistent with the arm's-length standard was contrary to the evidence before it; namely that unrelated parties, acting at arm's length, would never agree to share each other's stock-based compensation costs.

On 7 June 2019, in a 2-1 opinion, a Ninth Circuit panel reversed the Tax Court's holding and ruled that the 2003 regulations complied with the *Administrative Procedure Act*. The Ninth Circuit found that the government had adequately supported in the record that stock-based compensation should be treated as an intangible development cost in a cost-sharing arrangement and Treasury's position on the issue was not a policy change.

On 10 February 2020, Altera filed a petition for a writ of certiorari asking the Supreme Court to review the Ninth Circuit's decision. Altera contended that Treasury used an indefensible "bait-and-switch" by attempting to justify the 2003 regulations using arguments that it advanced for the first time in the Ninth Circuit after the Tax Court held the regulation invalid.

After Treasury filed a petition opposing Altera's petition for Supreme Court review, Altera filed a reply brief arguing that the Ninth Circuit committed serious errors by "upholding an arbitrary and capricious regulation based on a rationale presented for the first time in litigation, and even giving the new rationale *Chevron* deference." Altera stressed that the Supreme Court should grant certiorari because the Ninth Circuit's decision created uncertainty and confusion for international and domestic tax law. Altera rejected Treasury's argument that the Supreme Court should wait for a circuit split, saying most of the financial impact will be felt in the Ninth Circuit and there are no other cases in the pipeline.

The Supreme Court's denial of the petition for certiorari is important because the Ninth Circuit's decision stands. Companies within the Ninth Circuit must consider the Ninth Circuit decision concerning the inclusion of stock-based compensation in a cost-sharing agreement. Companies outside the Ninth Circuit must now consider how the Supreme Court's denial to hear the petition impacts their tax positions under the 2003 regulations. To this end, the Tax Court decision, issued on 27 July 2015, holding that the 2003 regulations were invalid, remains relevant precedent outside the Ninth Circuit.

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

The IRS in mid-May 2020 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.

IRS releases FAQs on transfer pricing documentation best practices

The IRS in mid-April 2020 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 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 upon.

The FAQs should be viewed in the context of the IRS's continued attention to 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.

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 in early April 2020 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.

Alignment of transfer pricing regulations to TCJA provisions in relation to IP definition not expected before 2021

The IRS will not be issuing regulations that align the transfer pricing rules to changes introduced by the *Tax Cuts and Jobs Act* (TCJA) in relation to the definition of intangible property before 2021, an IRS official said in early March 2020.

The official was also quoted as saying a regulation that addresses the valuation of transactions on an aggregate basis is expected to be released sometime in 2020.

The TCJA moved the definition of intangible property (IP) from Section 936(h)(3)(B) to Section 367(d)(4) and included goodwill, going-concern value and workforce in place within the definition. The law also confirmed the position the IRS has taken that the Secretary can require IP transfers to be valued on an aggregate basis or on the basis of realistic alternatives to the transaction.

Digital taxation

US announces action against France's DST

The US Trade Representative (USTR) on 10 July 2020 announced that the United States would take action against France's Digital Services Tax (DST) in the form of an additional 25% ad valorem duty on specified French-origin goods. The tariffs are scheduled to take effect on 6 January 2021, 180 days after the determination of action. The list covers 21 tariff subheadings, with an estimated trade value for calendar year 2019 of approximately $1.3 billion.

The announcement came after the US withdrew from negotiations regarding DSTs at the OECD level in June 2020.

US Treasury Secretary calls for 'pause' in BEPS 2.0 Pillar 1 discussions

Treasury Secretary Steven Mnuchin on 12 June 2020, sent a letter to several of his European counterparts regarding the ongoing BEPS 2.0 project, in response to their proposal to approach the project's Pillar 1 nexus and profit allocation element with a staged approach under which new Pillar 1 rules in 2020 would cover only digital business activity.

The US letter rejected the European proposal, indicating that talks had reached an impasse and called for a pause in the Pillar 1 discussions, with a view to resuming discussions later in the year and the hope that agreement could be reached in 2020. The letter further indicated that the discussions of the Pillar 2 minimum tax element are closer to agreement and communicated that the US fully supports concluding the Pillar 2 work this year.

The OECD responded by issuing a statement from the Secretary General that called on all members of the Inclusive Framework on BEPS to remain engaged on the project and expressed concern about the implications of unilateral action rather than a multilateral solution. The OECD plans to continue the technical work on the project as well as planned meetings.

Testifying during a House Ways and Means Committee hearing on 17 June, US Trade Representative (USTR) Robert Lighthizer addressed the situation. He said a variety of countries had decided that the easiest way to raise revenue is to tax other nations' companies like US tech companies; the US will not let that happen. The OECD negotiations were "not making headway on Pillar 1, which is the most important pillar in there," he said.

The USTR said we need an international regime that not only focuses on certain sides and industries, but how to tax corporations internationally.

In the wake of the US Treasury Secretary's letter, Pascal Saint-Amans, Director of the OECD's Centre for Tax Policy and Administration, reiterated on 24 June that the talks were still alive. "The U.S. has said . . . they are engaged, they want a solution, but we should shift it to 2021, or at least [until] after the [US] election." "What is for sure is that . . . we keep working, we're alive, we are not on life support," Saint-Amans said. "COVID has not done too much harm yet on this, but we recognize the difficulties."

USTR initiates investigations into digital services taxes either adopted, or under consideration, by 10 jurisdictions

On 2 June 2020, the United States Trade Representative (USTR) announced investigations will be conducted into certain foreign jurisdictions relating to the adoption – or contemplated adoption – of a digital services tax (DST). As outlined in a corresponding Federal Register Notice, jurisdictions included within the scope of the announcement include: Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey and the United Kingdom.

Investigations will be conducted pursuant to Section 301 of the *Trade Act of 1974* (Section 301), with the goal of determining whether the adopted or contemplated DST of the relevant jurisdiction is unreasonable or discriminatory as well as whether it burdens or restricts US commerce.

In the event the USTR concludes that a particular DST policy falls within the scope of Section 301, the USTR will then decide how the DST policy is to be addressed.

Past USTR actions have included targeting specific categories of goods in certain industry subsectors. If the respective DSTs are found to be discriminatory, similar actions may be taken with respect to each implicated jurisdiction. Consequently, as the investigations progress, companies should be sure to fully understand the extent of products, particularly, the Harmonized Tariff Schedule of the US classifications and country of origin for trade flows between the impacted jurisdictions and the US.

Companies with transactions involving the investigated jurisdictions, and therefore, potentially subject to actions on DST, should closely monitor the investigation process.

Treasury Secretary confirms DST deal with France

US Treasury Secretary Steven Mnuchin confirmed during a 12 February 2020 Senate Finance Committee hearing on the FY 2021 budget that the United States and France had, in fact, reached agreement to de-escalate tensions over France's enactment of a digital services tax (DST).

According to press reports in January, France agreed to suspend collection of the 3% DST and, in turn, the US agreed not to impose retaliatory tariffs of up to 100% on approximately US$2.4 billion of French goods. No action reportedly would be taken by either side through the end of 2020 in the hopes of reaching a multilateral digital tax agreement. (In February, France announced that it will suspend 2020 collection of the DST until December 2020, but 2019 DST remained due in April 2020.)

Secretary Mnuchin further was quoted as saying that reaching a multilateral digital solution is a "priority for us for the balance of this year."

Foreign Account Tax Compliance Act (FATCA)

IRS updates FATCA FAQs

The IRS in late April 2020 updated its *Foreign Account Tax Compliance Act* (FATCA) FAQ website in regard to FATCA certifications due on 1 July 2020. The IRS indicated it would 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 also provided 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.

Earlier, the IRS had announced on the IRS website that foreign financial institutions filing a FATCA Report (Form 8966) to the IRS that was generally due on 31 March were granted an extension to file to 15 July 2020. A Form 8809-I, Application for Extension of Time to File FATCA Form 8966 was not required for this extension.

Final FATCA and chapter 3 regulations issued

Treasury and the IRS in January 2020, 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 forms

IRS releases new draft partnership Schedules K-2 and K-3 for international tax reporting

The IRS in July 2020 released for comment new draft Schedules K-2 and K-3 for the 2021 tax year IRS Form 1065, *U.S. Return of Partnership Income*. The new IRS schedules and accompanying instructions are designed to help partnerships report certain US international tax information to their partners in a standardized format.

IRS seeks 2020-2021 Priority Guidance Plan recommendations

The IRS in early June 2020 issued Notice 2020-47, requesting recommendations from the public for guidance projects to be included in the 2020 - 2021 Priority Guidance Plan. Recommendations were requested to be submitted by 22 July 2020, although suggestions will be accepted anytime during the year.

Proposed PTEP regulations delayed

Although the Government expected to release proposed regulations on previously taxed earnings and profits (PTEP) before the end of the 2020 calendar year, those regulations were not released.

This information should assist partners in computing and reporting their corresponding US income tax liability, including under the new US international tax regimes enacted as part of the 2017 *Tax Cuts and Jobs Act*.

The new draft 2021 tax year IRS Schedules and instructions include:

- Schedule K-2 (Form 1065), *Partners' Distributive Share Items – International*
- Schedule K-3 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc. – International*
- Partnership Instructions for Schedule K-2 (Form 1065) and Schedule K-3 (Form 1065)
- Partner's Instructions for Schedule K-3 (Form 1065)

Partnerships must complete the new schedules beginning in tax year 2021 (filing season 2022) if they (1) must file a US partnership tax return (IRS Form 1065) and (2) have items of US international tax relevance (in general, certain specified non-US activities or non-US person partners). The new draft schedules do not affect partnerships with no US international tax items to report.

Partnerships and other affected stakeholders may review the proposed changes and submit comments. The IRS plans to finalize the forms later in 2020.

The IRS plans similar revisions to the 2021 IRS Forms 1120-S, *U.S. Income Tax Return for an S Corporation*, and 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, and invites comments on changes to these forms.

Miscellaneous

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.

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.

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 (NRAs) that fail to report rental income from US property. According to the IRS's 5 October 2020 announcement, this campaign will address noncompliance through examinations, education, and outreach.

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 provided 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 provided 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 provided 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 in April 2020, 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.

The following articles are OECD BEPS-related developments over the period 1 January - 31 December 2020.

OECD

Digital taxation

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."

OECD releases Pillar One and Pillar Two 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 was open for stakeholder input until 14 December 2020 and all written comments received will be made publicly available.

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.

G20 Finance Ministers and Central Bank Governors' meeting communiqué reiterates commitment to address digitalization tax challenges

On 18 July 2020, the G20 Finance Ministers and Central Bank Governors met via videoconference. At the conclusion of the meeting, a joint communiqué was issued. It stressed the importance of continuing to advance the work on addressing the tax challenges of the digitalization of the economy and reaffirmed the G20's commitment to reaching a global, consensus-based solution.

The G20 communiqué confirmed the OECD's current plan to develop blueprints for both Pillar One on new nexus and profit allocation rules and Pillar Two on new global minimum tax rules. The blueprints will be discussed by the member jurisdictions of the Inclusive Framework on BEPS at its early October meeting, and subsequently reported on to the G20 Finance Ministers and Central Bank Governors before their meeting on 15-16 October 2020.

New refocusing on BEPS, OECD official says

Although the global COVID-19 pandemic had disrupted government efforts on the BEPS 2.0 project, according to Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration, in May 2020 governments were ready to return to that work. Saint-Amans was quoted as saying that there had 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.

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.

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.

Saint-Amans disclaimed the existence of a "third pillar" focusing on a global excess profits tax to raise revenue following the coronavirus pandemic. He did suggest, however, there could be a third pillar internally at the OECD focusing on BEPS rules for lesser developed countries (which might not benefit sufficiently from the original BEPS projects).

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 had adapted its work on other projects due to the crisis.

In response to the COVID-19 crisis, the OECD had been 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. 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. The OECD also was considering addressing unique transfer pricing issues cropping up as a result of the COVID-19 pandemic.

In parallel, the OECD had been continuing its work on the full range of ongoing tax projects. Regarding the project on addressing the tax challenges of the digitalization of the economy, the OECD indicated that progress was being made toward the objective of reaching agreement with respect to Pillar 1 and Pillar 2 by the end of 2020. In contrast, it was necessary to postpone until October 2020 the meeting of the Inclusive Framework on BEPS (scheduled for July), together with the interim target of agreement on key policy features of new rules. Work on the BEPS project was expected to continue into 2021.

OECD BEPS 2.0 project to continue on current timelines

There had 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 noted that the reforms being developed with the BEPS 2.0 project were more important than ever, as governments will need to begin to focus on revenue needs. At the same time, a variety of countries continued 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 announces preliminary impact assessment and economic analysis of BEPS 2.0 project proposals

On 13 February 2020, the OECD Secretariat hosted a webcast to provide a summary of the preliminary results of its analysis of the impact on countries' tax revenues of the proposals being developed under the BEPS 2.0 project. These preliminary results were presented to the participating jurisdictions at the Inclusive Framework meeting on 29-30 January 2020.

The Secretariat grouped countries into "high-income," "middle-income," "low-income" and "investment hubs" – by reference of gross domestic product per capita of each country – and provided results at the level of such country groups. No results at a country-specific level were provided on the webcast.

Overall, the OECD Secretariat expected the combined effect of Pillars One and Two to be a significant increase in global tax revenues. The Secretariat's analysis estimated that the global net revenue gain could be up to 4% of global corporate income tax revenues, or US$100 billion annually. As a share of corporate tax revenues, the Secretariat's estimates of the revenue gains were broadly similar across the groups of high, middle and low-income countries. The Secretariat did not provide any information on the estimated impact on the revenue impacts for investment hubs.

With regard to "Amount A" of Pillar One—i.e., apportionment of profits of a multinational enterprise (MNE) group to a jurisdiction even when the group has no physical presence or product there—the analysis showed that, on average, low and middle-income economies would gain relatively more revenue than advanced economies. Moreover, more than half of the profit that would be reallocated would come from only 100 MNE groups.

The OECD Secretariat modeled four different scenarios for Pillar Two, using 12.5% as the assumed minimum tax rate and based on the income inclusion approach and a country-by-country measurement (i.e., jurisdiction blending). The scenarios were:

- A minimum tax assuming no interaction with Pillar One
- A minimum tax with interaction with Pillar One but no profit shifting behavior change by MNEs
- A minimum tax with interaction with Pillar One and a change in profit shifting behavior by MNEs
- A minimum tax with interaction with Pillar One, a change in profit shifting behavior and countries raising tax rates

Based on the OECD Secretariat's analysis, the outcome of all four scenarios would be similar overall increases in tax revenues; however, the cause of the increase in tax revenue would be different across the scenarios. The OECD Secretariat concluded that Pillar 2 would raise significant tax revenues, reduce tax rate differentials between jurisdictions and reduce the incentives for MNEs to shift profit.

The OECD Secretariat noted that the proposals under consideration were expected to lead to a significant reduction in profit shifting. They also expressed the view that a failure to reach a consensus-based solution would lead to further unilateral measures and greater tax uncertainty.

OECD announces renewed Inclusive Framework 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. According to the Statement, members of the Inclusive Framework – which includes 137 jurisdictions – affirmed their commitment to reach an agreement on new international tax rules by the end of 2020. The Statement and its more detailed annexes reflected the outcome of the plenary meeting of the Inclusive Framework on 29-30 January.

Attached to the Statement were 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 endorsed a unified approach as the basis for the ongoing negotiation of a consensus-based solution. With respect to Pillar Two, the Inclusive Framework welcomed the progress that had been achieved to date.

Country-by-Country Reporting (CbCR)

OECD holds public consultation on 2020 review of CbCR

On 12 and 13 May 2020 the OECD held a (video) consultation with respect to its public consultation document: *Review of Country-by-Country Reporting (BEPS Action 13)*. The consultation was an opportunity for stakeholders to engage directly with the OECD Secretariat and the country delegates of the Inclusive Framework on BEPS on the review of the country-by-country (CbC) reporting standard and the implementation experience to date.

The Secretariat stressed that no decision had been made on what changes to the CbC reporting standard could be made as a result of the review. A public consultation document released in February 2020 did not represent the consensus views of the Inclusive Framework. As to many of the topics referenced in the document, there was not yet agreement among the country delegates.

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 had been a significant compliance burden for businesses.

One proposal under discussion was to lower the reporting threshold for CbC reporting. As part of the BEPS 2.0 project regarding digitalization of the economy, standardizing this threshold for new rules under Pillars One and Two 2 had been suggested. Any lower reporting threshold therefore could have significant implications for businesses that extending beyond CbC reporting.

OECD releases consultation document on review of CbCR

On 6 February 2020, the OECD released a public consultation document on the review of Country-by-Country (CbC) Reporting. The 2015 BEPS Action 13 final report (*Transfer Pricing Documentation and Country-by-Country Reporting*) mandated a 2020 review of CbC reporting. The consultation document was released in connection with that review.

The consultation document contained topics concerning the implementation and operation of BEPS Action 13, the scope of CbC reporting, the content of a CbC report, and other aspects of BEPS Action 13 (the master file and local file). Those topics reflected issues where interpretative guidance had not resulted in a consistent approach applied by all jurisdictions and that could only be addressed through a change to the minimum standard. Such a change would require agreement by the Inclusive Framework, the group of 137 interested countries and jurisdictions participating on an equal footing in the development of standards on BEPS-related issues.

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

The OECD in January 2020 released additional guidance on implementation and operation of BEPS Action 13 Country-by-Country Reporting (CbCR). The new CbCR Guidance made it clear that, under the BEPS Action 13 minimum standard, the automatic exchange of CbC reports filed under local filing rules was not intended. The guidance was the OECD's tenth 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.

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.

Transfer Pricing

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.

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.

OECD releases CbCR comments

On 9 March 2020, the OECD released the compilation of comments received on the 2020 review of Country-by-Country Reporting (BEPS Action 13 minimum standard). The OECD received 79 contributions totaling 552 pages.

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 2019 mutual agreement procedure statistics, 2019 mutual agreement procedure awards

On 18 November 2020, the OECD held its second OECD Tax Certainty Day as a virtual event. During the event, the OECD published the 2019 Statistics on Mutual Agreement Procedures (MAP) and the 2019 MAP awards.

For 2019, the statistics include information from all OECD and G20 members and from those members of the OECD/G20 Inclusive Framework on BEPS that joined the Inclusive Framework prior to 2020 – for a total of 105 jurisdictions, an increase from the 89 jurisdictions covered in 2018 data. The 2019 data covers almost all MAP cases worldwide. Separate statistics are provided for transfer pricing cases and for "other cases" (i.e., non-transfer pricing) for 2019.

The 2019 MAP statistics include the number of MAP cases that each jurisdiction has with each of its treaty partners and each reporting jurisdiction's performance with respect to key indicators for each type of case can be compared through an interactive tool.

In addition, at the event, the OECD announced the 2019 MAP awards recognizing the particular efforts of competent authorities across a range of metrics.

OECD releases final transfer pricing guidance on financial transactions

On 11 February 2020, the OECD released its final report with transfer pricing guidance on financial transactions (the Report). The Report was published as follow-up guidance in relation to BEPS Action 4 and Actions 8-10.

It aims to clarify the application of the principles included in the 2017 edition of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TPG); in particular the accurate delineation analysis under Chapter I, to financial transactions. The Report represents the first time that guidance on financial transactions has been included in the OECD TPG, which should contribute to consistency in the application of transfer pricing and help reduce transfer pricing disputes and double taxation.

As noted, the Report covers the accurate delineation of financial transactions, in particular with respect to multinational enterprises' (MNEs) capital structures. The Report also addresses specific issues related to the pricing of financial transactions such as treasury functions, intra-group loans, cash pooling, hedging, guarantees, and captive insurance. It also provides guidance on the determination of risk-free rates of return and risk-adjusted rates of return where an associated enterprise is entitled to such return under the guidance in Chapter I and Chapter VI of the OECD TPG. The Report includes a number of examples to illustrate the principles discussed.

Key items discussed in the Report include:

- Intra-group lenders without functional substance
- Actual delineation of guaranteed loans
- Actual delineation of the terms of funding
- Cash pools
- Credit rating

Tax treaties

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 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 certain treaty-related issues that arise because of dislocation caused by the COVID-19 crisis. The guidance is only informational 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.

Peer reviews

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 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 releases outcomes of third phase of peer reviews on BEPS Action 13

On 24 September 2020, the OECD released the compilation of the outcomes of the third phase of peer reviews (the Compilation) of the minimum standard on Action 13 (*Transfer Pricing Documentation and Country-by-Country Reporting*) of the BEPS project. As Action 13 is a minimum standard, all members of the Inclusive Framework on BEPS have committed to implement it, and to be reviewed and monitored by their peers.

According to the executive summary accompanying the Compilation, over 90 jurisdictions have already introduced legislation to impose a filing obligation for Country-by-Country (CbC) Reporting (CbCR) on multinational enterprise (MNE) groups, covering almost all MNE groups with consolidated group revenue equal to or exceeding €750 million.

Where legislation is in place, the implementation of CbCR has been found to be largely consistent with the Action 13 minimum standard. However, 41 jurisdictions have received a general recommendation to either put in place or finalize their domestic legal or administrative framework. Of the jurisdictions that have already introduced the legislation, 34 jurisdictions received one or more recommendations to make improvements to specific areas of their framework. Moreover, 76 jurisdictions have multilateral or bilateral competent authority agreements in place, which results in more than 2500 exchange relationships. In addition, 82 jurisdictions have provided detailed information about the appropriate use of CbC reports, enabling the Inclusive Framework to obtain sufficient assurance that measures are in place to ensure the appropriate use.

The OECD also has indicated that the 2020 review of the CbCR minimum standard, which was announced in 2015 at the presentation of the BEPS Final Reports, will be finalized before the end of the year.

Second batch of Stage 2 peer review reports on dispute resolution released

On 9 April 2020, the OECD released the second batch of Stage 2 peer review reports relating to the outcome of the peer monitoring implemented 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.

Second annual peer review report on BEPS Action 6, prevention of treaty abuse, released

On 24 March 2020, the OECD released the second annual peer review report (the Report) relating to compliance by members of the Inclusive Framework on BEPS with the minimum standard on Action 6 for prevention of treaty abuse. The Report includes information available as of 30 June 2019 (the cut-off date) and covers 129 jurisdictions that were members of the Inclusive Framework by the cut-off date.

Overall, the Report concludes that the majority of the Inclusive Framework members have begun to translate their commitment to prevent treaty shopping into actions and are now in the process of modifying their treaty networks. According to the Report, the peer review results show the efficiency of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (MLI) in implementing the treaty-related BEPS measures.

The Report also notes that the MLI is by far the preferred tool of the Inclusive Framework members for implementing the BEPS Action 6 minimum standard.

Eighth batch of peer review reports on BEPS Action 14 released

The OECD on 24 February 2020 released the eighth batch of peer review reports relating to the implementation by Brunei Darussalam, Curaçao, Guernsey, Isle of Man, Jersey, Monaco, San Marino and Serbia of the BEPS minimum standard on Action 14 (*Making Dispute Resolution Mechanisms More Effective*). Guernsey and the Isle of Man had also requested that the OECD provide feedback concerning their adoption of the Action 14 best practices, and the OECD therefore also released two accompanying best practices reports.

Overall, the reports concluded that all eight assessed jurisdictions met almost all or most of the elements of the BEPS Action 14 minimum standard.

Third peer review report on Action 5 on exchange of tax rulings released

The OECD in mid-January 2020, released the third annual peer review report (the 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).

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 assessed the 2018 calendar-year period and contains 52 jurisdiction-specific recommendations. It indicated 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.

Dispute resolution

OECD releases Consultation Document on 2020 review of BEPS Action 14

The OECD on 18 November 2020 released a public Consultation Document on the review of the minimum standard on dispute resolution under BEPS Action 14. The assessment methodology for the peer review process of the Action 14 minimum standard included a planned evaluation of this process in 2020 in light of the experience in conducting peer monitoring.

Based on this experience, the 2020 review also presents an opportunity to re-examine what is viewed to be working well in the mutual agreement procedure (MAP) process and what issues could be further improved. The Consultation Document therefore sought stakeholder input on proposals for the 2020 review of the Action 14 minimum standard regarding the following items:

- Experiences with, and views on, the status of dispute resolution and suggestions for improvement, including experiences with MAP in those jurisdictions that obtained a deferral within the peer review process
- Additional measures that may strengthen the Action 14 minimum standard
- Additional measures that may strengthen the MAP Statistics Reporting Framework

The proposals included in the Consultation Document do not represent the consensus views of the OECD's Committee on Fiscal Affairs, the Inclusive Framework or its subsidiary bodies, but are intended to provide stakeholders with substantive proposals for analysis and comment. The press release highlights that while many jurisdictions expressed support for most of the proposals, several jurisdictions also raised strong concerns with some of them.

A public consultation meeting on the 2020 review of BEPS Action 14 will be held in early 2021.

Virtual currency

OECD releases report on taxing virtual currencies

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) in October 2020 released a report (the Report) on taxing virtual currencies that provides a cross-jurisdictional overview of the tax treatment and emerging tax policy issues in relation to virtual currencies. The jurisdictional overview is based on a questionnaire to identify domestic variations in taxation of crypto-assets, focusing in particular on the treatment of virtual currencies for purposes of income tax, property tax and Value Added Tax (VAT).

The Report was presented to the October 2020 meeting of G20 Finance Ministers and Central Bank Governors and covers three main areas:

1. Key concepts and definitions of blockchain and crypto-assets, looking at the characterization, legality and valuation of virtual currencies and analyzing the tax consequences across the different stages of their lifecycle, from creation to disposal.
2. Tax policy implications of several emerging issues related to the taxation of virtual currencies, including the rise of stablecoins (e.g., Libra, Tether) and "Central Bank Digital Currencies" (CBDC), as well as the evolution of the consensus mechanisms used to maintain blockchain networks (e.g., the increasing use of Proof-of-Stake rather than Proof-of-Work) and the rise of decentralized finance (DeFi).
3. Identification of key tax policy considerations based on a comparative overview across more than 50 countries of the tax treatment of virtual currencies from the perspective of income, consumption and property taxation. These policy considerations are not intended as recommendations or best practices, but rather are observations that domestic legislators and policymakers may take into consideration when strengthening their regulatory framework for taxing virtual currencies.

The Report is the first formal report of the OECD and the Inclusive Framework on BEPS that is specific to taxing virtual currencies and the related emerging tax policy issues. Although the Report does not explicitly contain recommendations, it is expected that the OECD will do more work on this topic. As such, the Report should be viewed as a first important step towards more clarity and guidance on several areas in relation to virtual currencies where policymakers currently face challenges.

Miscellaneous

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.

OECD releases new corporate tax statistics including anonymized and aggregated CbCR statistics

On 8 July 2020, the OECD released the second annual edition of the Corporate Tax Statistics publication (the CTS report) together with an updated database. The database is intended to assist in the study of corporate tax policy and expand the quality and range of data available for the analysis of base erosion and profit shifting (BEPS) activity.

For the first time, the database includes anonymized and aggregated Country-by-Country (CbC) reporting statistics, reflecting information for 2016 provided by 26 member jurisdictions of the Inclusive Framework on BEPS and covering about 4,000 multinational enterprise (MNE) groups that operate across more than 100 jurisdictions worldwide. The OECD also published a list of Frequently Asked Questions on the anonymized and aggregated CbC reporting data.

As highlighted in the press release accompanying the release of the report and the database, the OECD views the new statistics as suggesting some preliminary insights that, despite the data limitations, are indicative of the existence of BEPS behavior.

This second edition of the database also includes, for the first time, information on controlled foreign company (CFC) rules and on interest limitation rules, which the OECD indicates can assist in understanding progress related to the implementation of BEPS Actions 3 and 4.

OECD releases model rules for data reporting by platform operators for sellers in the sharing economy

On 3 July 2020, the OECD released *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy* (Model Rules as approved by the OECD/G20 Inclusive Framework on BEPS on 29 June 2020). The Model Rules lay out a system for requiring digital platforms to collect information on the income realized by those offering accommodation, transport and personal services through platforms and to report the information to tax authorities.

OECD releases Taxation of Offshore Indirect Transfers Toolkit

On 4 June 2020, the OECD released the final version of the Taxation of Offshore Indirect Transfers Toolkit, which is part of the Platform for the Collaboration on Tax project. The toolkit provides guidance on design and implementation issues when one country seeks to tax an entity that is a tax resident in another country on gains on the sale of interests in an entity that owns assets located in that country. It also includes two models for domestic legislation that countries could adopt to impose tax on such offshore indirect transfers.

The Platform for the Collaboration on Tax, begun at the request of the G-20, is a joint initiative of the International Monetary Fund, the OECD, the United Nations, and World Bank Group. It includes the development of a series of "toolkits" to help guide developing countries in the implementation of policy options for issues in international taxation. The latest toolkit represents the analysis and conclusions of the staffs of the four partner organizations, and does not represent the official views of the organizations or their member countries.

According to the press release accompanying the release of the indirect transfer toolkit, the taxation of offshore indirect transfers is a particular concern to developing countries, mostly but not exclusively countries that are rich in natural resources. The relevance of the topic has been magnified by the revenue challenges faced by governments around the world as a consequence of the COVID-19 crisis.

Businesses may want to review the toolkit and monitor the country developments related to the tax treatment of offshore indirect transfers.

OECD issues IT-tools to support implementation of TRACE, wider exchange of tax information

The OECD in late February 2020 released an XML Schema and User Guide to support the technical implementation of the OECD's Treaty Relief and Compliance Enhancement (TRACE) initiative (the TRACE XML Schema and User Guide). The TRACE XML Schema and User Guide provide guidance on the standardized electronic format to be used for reporting TRACE-related information by financial institutions to tax administrations and for the exchange of information between tax administrations.

the guide is intended to complement the TRACE Implementation Package, which sets out the procedures, forms and agreements to be put in place to operationalize the TRACE Authorized Intermediary system that was approved by the OECD's Committee on Fiscal Affairs in 2013.

The OECD also released a dedicated XML Schema and User Guide (the Generic Status Message XML Schema and User Guide) that allows tax administrations to provide structured feedback to the sender on errors encountered with respect to tax information exchanged through the Common Transmission System (CTS). The CTS is a secure, encrypted vehicle created by the OECD to enable bilateral exchanges of tax information.

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