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Washington Dispatch

February 2021, Volume 25, Issue 2

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Legislation

Congress poised to enact \$1.9t COVID-relief bill with repeal of worldwide interest expense allocation – but what's next?

The US House of Representatives on 27 February approved President Biden's US\$1.9 trillion COVID relief plan. The *American Rescue Plan Act* (H.R. 1319) now goes to the Senate for consideration where passage likely will require the support of all 50 Democrats, with Vice President Kamala Harris providing the tie-breaking vote.

The package would provide direct payments, a child tax credit expansion in the form of direct payments, extended unemployment benefits, COBRA subsidies and *Affordable Care Act* tax credit enhancements, relief for pension plans, state and local funding, among other provisions.

It also includes an international tax change that would repeal the election for US affiliated groups to allocate interest expense on a worldwide basis beginning in 2021. This now House-repealed election, contained in Section 864(f), was added to the tax code in 2004 but had been deferred several times. Repeal of the worldwide interest allocation rules would raise roughly \$22 billion over 10 years, according to a Joint Committee on Taxation estimate.

In the meantime, House Ways and Means Committee Chairman Richard Neal (D-MA) indicated in mid-February that there is no consensus among Democrats in Congress on the approach to take in terms of US taxation of multinationals – some consider it a revenue source while others want to reexamine *Tax Cuts and Jobs Act* (TCJA) provisions. The Chairman added that in the end, "Congress will work closely with the administration to secure favorable outcomes for the U.S. businesses headquartered right here."

On the topic of a corporate rate increase, Chairman Neal said harmonization of rates with the OECD makes some sense and, while nothing has been decided, the economic downturn "ought to cause us to be careful." The Chairman also indicated that he objects to retroactive taxation and noted the importance of putting the pandemic and recession behind us.

He said it is clear after meeting with President Biden on 5 February that, as soon as the current round of coronavirus relief is put in place, Democrats plan to proceed with an infrastructure initiative that includes a revival of the Build America Bonds program.

Treasury Secretary Janet Yellen has suggested that a corporate tax rate increase to 28% could be proposed in what is expected to be the infrastructure-plus "Build Back Better" package, but the intention to pay for the bill has since become less certain. There are press reports that Biden Administration officials and congressional Democrats may be open to an infrastructure bill that does not include tax increases and is instead paid for with debt.

In regard to the OECD Base Erosion and Profit Shifting (BEPS) 2.0 negotiations, Treasury Secretary Yellen on 26 February said during a virtual G20 finance ministers and central bank governors meeting that the US would no longer push for Pillar One to be implemented on a safe harbor basis. Trump Administration Treasury Secretary Steven Mnuchin had made the proposal in late 2019, suggesting that companies could opt into the Pillar One regime at their discretion. That position was generally opposed by US trading partners involved in the discussions.

Taking the US safe harbor proposal off the table is expected to be viewed as a major step forward in the global discussions. But negotiations will still require considerable work.

On Capitol Hill, Democrats on the congressional tax writing committee may not be that far apart from their Republican counterparts in terms of the Pillar One discussions. Democrats on the Finance Committee and the House Ways and Means Committee reportedly share opposition to unilateral Digital Services Taxes and generally agree with the Trump Administration's position on Pillar One, according to a senior Ways and Means staff member. Any support among Democrats for a proposed multilateral solution on Pillar One will be based on the revenue effects and positions taken by stakeholders, the official was quoted as saying.

Addressing the BEPS discussions at his 23 February 2021 Senate Finance Committee confirmation hearing to be the next Deputy Treasury Secretary, Adewale "Wally" Adeyemo did not break new ground beyond what Treasury Secretary Yellen has said previously. Adeyemo told the committee that US companies must be able to compete globally, and the US will work internationally through the OECD and G20 tax process to create a more level playing field for US companies with regard to taxation.

Transfer pricing news

Treasury to consider reviving expired transfer pricing aggregation regulations

Treasury may soon open a project to revive transfer pricing aggregation regulations under Section 482 that were issued in temporary form in 2015, but that expired in 2018 without being finalized, according to a report in the tax press in February 2021.

As background, in July 1994, the Treasury published final transfer pricing regulations under Reg. Section 1.482-1, which included a set of rules on the aggregation of interrelated transactions in determining arm's-length transfer pricing. The relevant portion of the regulation states:

The combined effect of two or more separate transactions (whether before, during, or after the [tax] year under review) may be considered, if such transactions, taken as a whole, are so interrelated that consideration of multiple transactions is the most reliable means of determining the [arm's-length] consideration for the controlled transactions. Generally, transactions will be aggregated only when they involve related products or services, as defined in [Reg. Section] 1.6038A-3(c)(7)(vii)

This regulation and its four subsequent examples provided guidance to taxpayers until it was replaced by new Temporary Reg. Section 1.482-1T(f)(2)(i) in 2015. The 2015 temporary regulation was built on the foundation of its 1994 predecessor with modifications and clarification that the arm's-length standard must be satisfied when both Sections 482 and 367 apply. The result was a more rigid aggregation principle with less taxpayer flexibility in pricing intercompany transactions that are interrelated.

Treasury initially planned to finalize the 2015 temporary regulation before it expired in 2018, but the project became less urgent after the *Tax Cuts and Jobs Act* (TCJA) amended the statutory text of Section 482 to explicitly allow aggregation for intangible transfers.

When the 2015 temporary regulation expired in September 2018, taxpayers were left with a statutory aggregation rule under Section 482 without further guidance for intangible property transfers occurring after 14 September 2018.

Although the IRS has generally considered the aggregation principle to be the most reliable means of determining arm's-length consideration for controlled intangible property transactions, the lack of current regulations on the application of aggregation to intangibles transfers generally leaves taxpayers with greater transactional flexibility.

If the Treasury does revive the 2015 temporary regulations, it is unknown how the new regulations will be issued. While it may be possible for the Treasury to use the prior proposed regulations to directly promulgate final regulations, it is more likely that the new regulations would be issued as part of a larger regulation package so that Treasury can solicit comments, and respond to those comments in the Preamble to the final regulations to avoid an *Administrative Procedures Act* challenge (similar to the *Altera* case).

It is also possible that, given the comprehensive international tax overhaul from the TCJA, Treasury will start from scratch and draft a more comprehensive overhaul of the transfer pricing regulations to incorporate other statutory changes from the TCJA, such as the new statutory definition for intangible property contained in Section 367(d)(4).

IRS continues APA/MAP case closures despite COVID restrictions

The IRS Advance Pricing and Mutual Agreement Program (APMA) has adapted well to the virtual environment resulting from the COVID-19 pandemic, according to a senior IRS official. Douglas O'Donnell, Commissioner of the IRS Large Business and International Division, in February was quoted as saying that case closures have been "surprisingly robust" despite the fact the work has become completely virtual.

In May 2020, the IRS [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 affects the handling of pending and executed APAs by the APMA.

Consistent with O'Donnell's remarks, EY's National Tax transfer pricing practice has observed an increase in MAP and APA case completions due to APMA's technological modifications and increased collaboration amongst taxing authorities. APAs and MAPs are critical tax dispute resolution tools for taxpayers to consider as tax controversies will likely increase due to tax authorities' responses to the global pandemic.

OECD developments

OECD Forum on Tax Administration releases new handbook for International Compliance Assurance Programme (ICAP)

On 18 February 2021, the OECD Forum on Tax Administration (FTA) released a [new handbook for the International Compliance Assurance Programme \(ICAP\)](#). According to an OECD media release, following two initial pilot programs, ICAP will now be run as a full program, open to all 53 FTA member tax administrations. This transition to a program with open membership follows the plenary session held by the FTA on 7 and 8 December 2020.

ICAP is a voluntary risk assessment and assurance program designed to facilitate open and cooperative multilateral engagement between large multinational enterprise (MNE) groups that are willing to engage actively and transparently and tax administrations in jurisdictions where the MNE groups have business activities.

Developed under the framework of the FTA Large Business and International Programme, two ICAP pilots were run in 2018 and 2019. The recently released handbook was assembled based on the experience from these two pilots and from feedback provided by tax administrations and MNE groups.

In broad terms, the core focus areas remain the assessment and assurance of transfer pricing risk, permanent establishment risk, and other categories of international tax risk (e.g., hybrid mismatch arrangements, withholding taxes, or treaty benefits) as agreed by the MNE group, the lead tax administration, and other covered tax administrations. However, the revised handbook contains some modifications to the procedural and administrative elements of the ICAP program.

Further information, including more frequently asked questions and a list of participating tax administrations, will be made available by the OECD on a [dedicated ICAP webpage](#) during March 2021.

The OECD will hold virtual OECD ICAP Awareness Events on 30 March 2021 at 09:00 (CEST) and on 1 April 2021 at 17:00 (CEST) for MNE groups to learn more about the program and ask any questions they may have.

For MNE groups interested in joining the program, the parent company should contact its local tax administration where it is tax resident to discuss possible ICAP participation in advance of the first deadline for submission. The upcoming dates to submit an application to participate are 30 September 2021, 31 March 2022, and 30 September 2022. Future deadlines will be released in due course.

Maryland becomes first US state to enact new taxes on digital advertising and sales of digital goods

The Maryland legislature on 12 February 2021 overrode the Governor's [veto](#) of [HB 732](#), which imposes a new tax on digital advertising, and [HB 932](#), which extends the state's existing sales and use tax to the sale of digital goods. Effective for tax year 2021, HB 732 imposes a tax on the annual gross revenue derived from digital advertising in the state. The tax applies a graduated rate that increases in increments based on the taxpayer's global annual revenues.

Concerns have been raised that the state's tax on digital advertising potentially violates the First Amendment and Commerce Clause of the US Constitution and could be preempted by the federal *Tax Freedom Act* because Maryland exempts other forms of advertising (non-digital) from tax. Thus, even with the veto override, legal challenges can be expected to delay or even invalidate the measure. (The tax press reported that the first suit against the new tax was filed on 18 February 2021.)

The tax was also criticized as effectuating bad policy by potentially subjecting entities that provide or purchase digital advertising services in Maryland to a double tax, as they already are subject to corporate or personal income taxes on their in-state earnings. Nevertheless, legislators in other states, including New York, Connecticut, Indiana, Montana, Nebraska, Oregon and Washington, have recently proposed similar sales/consumption-based taxes on gross receipts from digital advertising services or on the sale or exchange of personal data.

OECD holds public consultation on review of minimum standard on dispute resolution under BEPS Action 14

On 1 February 2021, the OECD held a public consultation with respect to the review of the minimum standard on dispute resolution under BEPS Action 14. The proposals on which the OECD was seeking comments were outlined in an earlier [Consultation Document](#). (EY was one of 33 professional service providers, businesses, industry associations, and individuals that provided [comments](#) on the Consultation Document. EY submitted a [comment letter](#) and a global team from EY participated in the consultation.)

While the majority of comments made by panelists and other participants in the public consultation were broadly in line with the recommendations made by the OECD, there was some divergence in opinion on key proposals relating in particular to their implementation in developing countries.

The public consultation on improving dispute resolution was held at a time of increasing complexity in tax audits and disputes as well as the disruption wrought by the COVID-19 pandemic - the latter of which has already had wide-ranging impacts on transfer pricing generally. In such circumstances, the need to increase the accessibility, efficiency, and efficacy of cross-border dispute resolution programs is critical to the proper operation of the international tax system. As the OECD considers the comment submissions, we expect more material on Action 14 and further proposals for improvement to be produced over the coming months.

OECD releases 10th batch of peer review reports on BEPS Action 14 related to improving dispute resolution

On 16 February 2021, the OECD released the 10th batch of peer review reports, which relate to the implementation by Aruba, Bahrain, Barbados, Gibraltar, Greenland, Kazakhstan, Oman, Qatar, Saint Kitts and Nevis, Thailand, Trinidad and Tobago, United Arab Emirates (UAE), and Vietnam of the BEPS minimum standard on Action 14 (Making Dispute Resolution Mechanisms More Effective).

Overall, the reports conclude that most of the assessed jurisdictions meet almost all or the majority of the elements of the Action 14 minimum standard, with the exception of Kazakhstan and Vietnam which meet less than half of the elements of the Action 14 minimum standard.

OECD, UN, IMF and World Bank Group present toolkit on the implementation of effective transfer pricing documentation requirements

The Platform for Collaboration on Tax - a joint effort of the OECD, United Nations, International Monetary Fund and World Bank Group - released a [toolkit](#) designed to help developing countries with the successful implementation of effective transfer pricing documentation requirements. The toolkit compiles information on transfer pricing documentation and analyzes policy choices and legislative options.

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EYG no. 001601-21Gbl

1508-1600216 NY
ED None

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