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Legislation

Treasury Green Book offers new details on international tax proposals

The US Treasury on 28 May 2021 released its FY 2022 explanation of the Biden Administration's revenue proposals (the Green Book), offering new details on the various proposals included in the President's "Made in America" tax plan.

The Made in America tax plan was first released in March 2021 and was followed by a Treasury report detailing the Administration's corporate tax proposals, including increasing the corporate tax rate from 21% to 28% and significant changes to international tax provisions. The major international tax proposals include:

- Increased tax rates and other changes to the regime for Global Intangible Low-taxed Income (GILTI)
- Country-by-country limitations on foreign tax credits
- Repeal of the deduction for Foreign-derived Intangible Income (FDII)
- Replacement of the Base Erosion and Anti-abuse Tax (BEAT) with a newly proposed "SHIELD" (Stopping Harmful Inversions and Ending Low-tax Developments)
- Expanded rules targeting inversions
- A new minimum tax on book income
- Limits on interest deductions for disproportionate borrowing in the US
- Treatment of dispositions of "specified hybrid entities" as stock sales for certain purposes

Most of the proposals would be effective for tax years beginning after 31 December 2021, though several are proposed to be effective for transactions completed after the date of enactment. The proposal to repeal BEAT and introduce SHIELD would be effective for tax years beginning after 31 December 2022.

GILTI/Subpart F

The Made in America tax plan would increase the tax rate on GILTI from 10.5% to 21% by reducing the Section 250 deduction to 25% from 50%. Furthermore, the plan would eliminate the exemption from GILTI of a net deemed tangible income return (qualified business asset investment), currently equal to 10% of a US shareholder's share of CFC adjusted basis in qualified business asset investments.

The Green Book would repeal the high tax exception for both GILTI and subpart F. It would also expand Section 265 to disallow deductions allocable to foreign gross income that is exempt from tax (such as income eligible for a dividends-received deduction under Section 245A) or foreign gross income subject to a lower rate through a deduction (such as a Section 250 deduction on GILTI).

Country-by-country FTC limitation

The Green Book would determine a US shareholder's GILTI inclusion and FTC limitation on a country-by-country basis, thus preventing excess foreign tax credits from high-tax jurisdictions from being credited against GILTI inclusions from low-tax jurisdictions. The Green Book would also expand the country-by-country limitation to branch income.

For a foreign parented controlled group, the Green Book would allow US shareholders to take into account taxes paid by a foreign parent under an income inclusion rule that is consistent with an OECD/Inclusive Framework Pillar Two agreement if a consensus is reached at the OECD.

FDII and jobs incentives

The Green Book would repeal the FDII deduction and replace it with tax-based incentives for research and development (R&D) in the United States. No details are provided on how domestic R&D would be incentivized under the Green Book proposal, though the budget scoring indicates new incentives would match the revenue raised by eliminating FDII.

The Green Book also proposes to create a new 10% general business credit for eligible expenses incurred in connection with onshoring to the US a trade or business that is currently conducted outside the US. Conversely, the Green Book would disallow deductions for expenses paid or incurred at the US or CFC level in connection with offshoring a US trade or business if the offshoring would result in a loss of US jobs.

Replacement of BEAT with SHIELD

The Green Book proposes to repeal the BEAT and replace it with SHIELD. SHIELD would deny deductions "by reference to all gross payments that are made (or deemed made)" to related entities whose income is subject to a low effective rate of tax (ETR). The threshold rate of tax for disallowance would be the GILTI rate of 21% until the adoption of a multilateral agreement on global minimum tax rates under the OECD's BEPS initiative. According to press reports, Treasury proposed on 20 May that the global minimum tax rate should be at least 15% and that discussions should continue to push that rate higher. The Green Book provides these additional details on SHIELD:

- ETR is determined based on (1) income earned (in the aggregate, taking into account both related and unrelated party income), and (2) taxes paid or accrued with respect to income that is earned in that jurisdiction. Both income earned and taxes paid or accrued are based on separate or disaggregated financial statements on a country-by-country basis.
- Treasury could provide special rules to address differences (both permanent and temporary) between the relevant income tax base and the base as determined under financial accounting. It could also provide rules to account for net operating losses in a jurisdiction.
- Deductible payments made by a domestic corporation or branch directly to low-tax members would be subject to the SHIELD rule in their entirety. Payments for other types of costs (such as cost of goods sold), as well as other deductions (including unrelated-party deductions), would be disallowed up to the amount of the payment.
- Payments made to non-low-tax members would be partially subject to the SHIELD rule to the extent that other group members are subject to an ETR below the designated minimum tax rate in any jurisdiction.

SHIELD would apply to financial reporting groups with greater than $500 million in global annual revenues, although Treasury could exempt payments to domestic and foreign members that are investment funds, pension funds, international organizations, or non-profit entities, and take into account payments by partnerships.

Anti-inversion/Section 7874

The Green Book proposal would modify current inversion rules by generally treating a foreign acquiring corporation as a US corporation if former shareholders in an acquired US corporation own 50% of the foreign acquiring corporation after the combination (instead of 80%).

The Green Book proposal would also expand the inversion rules to apply regardless of the level of shareholder continuity if:

- The fair market value of the domestic entity is greater than the fair market value of the foreign acquiring corporation immediately before the acquisition
- The expanded affiliated group is primarily managed and controlled in the United States after the acquisition
- The expanded affiliated group does not conduct substantial business activities in the country in which the foreign acquiring corporation is created or organized

The proposal would expand the scope of acquisitions covered by the inversion rules and also cover certain distributions of foreign corporation stock by a domestic corporation or a partnership. The expansion of the inversion rules would be effective for transactions that are completed after the date of enactment.

Minimum book tax

The Made in America tax plan would introduce a minimum book tax on certain large multinational corporations. According to the Green Book, a 15% minimum tax would apply to the company's book income that is generally reported to investors. In-scope companies, those with a calculated base in excess of $2 billion, would make an additional payment to the IRS for the excess of up to 15% on their book income over their regular tax liability. Companies would be given credit for taxes paid above the minimum book-tax threshold in prior years, for book net operating loss deductions, for general business tax credits (including research, clean energy, and housing tax credits) and for foreign tax credits.

Interest limitation for disproportionate borrowing in the US

The Green Book introduces a new limitation on interest deductions that would apply to an entity that is a member of a multinational group preparing consolidated financial statements in accordance with US Generally Accepted Accounting Principles or International Financial Reporting Standards. The provision is similar to Section 163(n), which was proposed, but never enacted, in the run-up to the *Tax Cuts and Jobs Act of 2017*.

A member's interest deduction would be limited if the member's net interest expense for financial reporting purposes is greater than the member's proportionate share of the financial reporting group's net interest expense reported on the group's consolidated financial statements.

US proposes 15% global corporate minimum tax to BEPS 2.0 Steering Group

US Treasury officials and members of the Steering Group of the OECD Base Erosion and Profit Shifting (BEPS) Inclusive Framework met for two days in mid-May in Washington DC, during which the US Government proposed that the global corporate minimum tax rate (Pillar Two) should be at least 15%.

According to a Treasury read out of the meetings, Treasury underscored that the 15% rate was a floor and that "discussions should continue to be ambitious and push that rate higher." Treasury officials were "heartened" by the positive reception they received at the meeting regarding their global minimum tax proposal.

According to Treasury, it is "imperative to work multilaterally to end the pressures of corporate tax competition and corporate tax base erosion." The "race to the bottom" in regard to corporate tax rates has undermined the ability of the US and other countries to raise the necessary revenue for critical investments, the Treasury statement read. Treasury contends that a global corporate minimum tax would "ensure the global economy thrives based on a more level playing field in the taxation of multinational corporations," resulting in greater innovation, growth and prosperity.

Dispositions of specified hybrid entities

The Green Book proposes to limit the ability to claim foreign tax credits in respect of gain from the sale of entities that are treated as corporations under foreign law but as partnerships or disregarded entities for US tax purposes (specified hybrid entities). Specifically, it would treat the source and character of any item resulting from the disposition of a specified hybrid entity, for FTC purposes, as if the seller had sold or exchanged stock of a corporation instead of the assets owned by the specified hybrid entity.

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With a closely divided House and an evenly split Senate, the details of the international tax provisions in the Green Book are likely to change during the legislative process, making the prospects for enactment unclear. Nevertheless, the Green Book demonstrates that the Biden Administration is committed to fundamental changes to the international tax rules and to aligning key proposals such as SHIELD to the OECD BEPS 2.0 Pillar Two proposals. By using the key new details in the Green Book, taxpayers can better model the potential impact of the international tax proposals on their planning and operations, although many key design features of these proposals still need to be clarified.

Senate hearing discusses Biden Administration's international tax proposals

The Senate Finance Committee hearing on four Treasury nominations on 25 May 2021, including for Lily Batchelder as Assistant Treasury Secretary for Tax Policy, featured significant discussion of international tax changes proposed by President Biden as well as the OECD BEPS 2.0 negotiations. Senator Rob Portman (R-OH) expressed concern about the Administration's proposal to double the Global Intangible Low-taxed income (GILTI) rate to 21% – which, with the proposed retention of the 20% foreign tax credit haircut for GILTI, would make the rate 26% – noting its impact on US competitiveness.

Ranking Member Mike Crapo (R-ID) expressed concerns about changing the GILTI rate ahead of an OECD agreement and, in a 24 May letter asked Treasury Secretary Janet Yellen for more information regarding the OECD BEPS 2.0 Pillar One negotiations, including how many US companies would be affected, which companies would be treated as "in scope," the magnitude of profits that would be reallocated, and the effect on US tax revenues. Other senators on the committee asked about the effect of the 10% deemed return for tangible assets for companies building factories in high-tax jurisdictions and the importance of a global minimum tax, as well as voiced concerns about potential exemptions or carve-outs for some countries.

House bill would require SEC regulations on CbC financial information disclosure, including taxes

The House Financial Services Committee on 12 May 2021 reported out six bills, including one that would require the Securities and Exchange Commission (SEC) to promulgate regulations requiring larger corporations to disclose country-by-country financial information on each of their subsidiaries, including profits, taxes paid, employees and tangible assets.

The *Disclosure of Tax Havens and Offshoring Act* (HR 3007) would require public companies with annual revenues of $850 million or more to disclose their total pre-tax profits, tangible assets and total amounts paid in state, federal and foreign taxes. The bill would also require companies to disclose a number of specific tax-related items for each of their subsidiaries, as well as on a consolidated basis, such as total accrued tax expenses, stated capital and total accumulated earnings. Republicans on the committee warned that the new tax disclosures would threaten companies' right to confidentiality.

IRS news

President Biden proposes increased IRS budget to improve tax compliance

On 28 April 2021, the US Treasury issued a press release detailing the Government's plan to increase resources to the IRS in order to improve tax compliance.

According to the release, President Joe Biden proposes to direct $80 billion to the IRS over the next 10 years to: (i) improve technology; (ii) increase the hiring and training of auditors to focus on complex investigations of large corporations, partnerships and global high-wealth individuals; and (iii) increase enforcement against high-income individuals.

Treasury expects these changes to result in $700 billion in tax revenue over the next 10 years.

Treasury also said it wants the IRS to implement a mechanism for cross-checking the accuracy of tax filings from "opaque sources," such as partnerships and proprietorships. Treasury indicated it will leverage "the information that financial institutions already know about account holders, simply requiring that they add to their regular, annual reports information about aggregate account outflows and inflows."

IRS modifies guidance on accounting method changes for certain foreign corporations

The IRS in May 2021 issued Revenue Procedure 2021-26, establishing procedures under Section 446(e) for certain foreign corporations to obtain automatic consent to change their method of accounting to the alternative depreciation system (ADS) under Section 168(g). The revenue procedure also (i) provides additional terms and conditions applicable to Section 481(a) adjustments arising from accounting method changes of foreign corporations; and (ii) clarifies an existing rule that limits audit protection for certain foreign corporations (the 150% rule).

Section 951A requires a US shareholder of any controlled foreign corporation (CFC) to include the shareholder's Global Intangible Low-taxed Income (GILTI) in gross income. GILTI is the excess of the shareholder's net tested income over its net deemed intangible return for the tax year. Very generally, the net deemed intangible return is the excess of 10% of the shareholder's qualified business asset investment (QBAI) over its pro rata shares of certain interest expense from all its CFCs. QBAI is determined by reference to CFCs' adjusted bases in specified tangible property as determined by using ADS under Section 168(g).

When computing tested income and earnings and profits (E&P), taxpayers may use depreciation methods other than ADS. Given the requirement to use ADS to determine the adjusted basis for purposes of calculating QBAI , CFCs not otherwise required to use ADS to compute their income and E&P may want to change to ADS for tangible property to conform their income, E&P and QBAI computations.

Revenue Procedure 2021-26 temporarily permits CFCs on an impermissible non-ADS method, as well as CFCs on a permissible non-ADS method, to obtain automatic consent to change their method of accounting for depreciation to ADS when determining their gross and taxable income under Reg. Section 1.952-2 and E&P under Sections 964 and 986(b).

This change is effective for a Form 3115 filed on or after 11 May 2021 for a CFC's tax year ending before 1 January 2024.

IRS official comments on treaty derivative benefits post-Brexit

An IRS official in May 2021 discussed issues with regard to the application of the derivative benefits test post-Brexit. Some US tax treaties include a derivative benefits test in the Limitation on Benefits (LOB) Article, which evaluates, in part, whether the owners of the treaty claimant may be considered an equivalent beneficiary. Following Brexit, as the United Kingdom (UK) is no longer part of the European Union, UK companies may no longer qualify for equivalent beneficiary status.

The American Bar Association Section of Taxation virtual panel discussed ways to address the issue and the IRS official noted that, from Treasury's perspective and [that of] IRS, other concerned countries are encouraged to contact Treasury about modernizing their LOB provisions. "It is probably the more cumbersome of the options, but from our perspective, it's probably the most structurally sound and viable long-term solution," he said.

The panel also discussed requesting competent authority relief on a case-by-case basis in these circumstances, noting that the approach may be time-consuming and there is no guarantee that the IRS will grant the taxpayer's request. Another possibility discussed was whether the US could enter into a bilateral competent authority agreement; the panel noted that this approach would test Treasury's authority to overrule the text of a ratified tax treaty and also could have certain political implications.

Government releases early drafts of 2021 Schedules K-2 and K-3 for Forms 1065, 1120-S and 8865

Treasury and the IRS on 30 April 2021 released updated early drafts of new Schedules K-2 and K-3 for Forms 1065, 1120-S, and 8865 for tax year 2021 (filing season 2022). The schedules are meant to provide greater clarity for partners and shareholders to compute their US income tax liability with regard to items of international tax relevance, including deductions and credits. The early release drafts of Schedules K-2 and K-3 provide a preview of what is coming in the final versions; early draft of instructions are expected this summer.

An IRS release indicated that the Treasury Department and the IRS took into account comments received with respect to prior drafts of Schedules K-2 and K-3 for Form 1065, (released in July 2020), and changes were made as appropriate.

Transfer pricing

PR Treasury issues guidance for complying with the requirement to submit a transfer pricing study

The Puerto Rico Treasury Department (PRTD) in May 2021 issued guidance (Administrative Determination (AD) 21-05) for complying with the requirement to submit a transfer pricing study to claim expenses paid to related entities that do not carry out operations in Puerto Rico or have a home office located outside of Puerto Rico (intercompany charges) on the income tax return.

Under Section 1033.17(a)(16) and (17) of the Puerto Rico Internal Revenue Code of 2011 (PR Code), as amended, taxpayers cannot deduct 51% of intercompany charges on the income tax return. The limitation does not apply to income derived from operations covered by a decree, resolution or a tax exemption grant.

For tax years beginning after 31 December 2018, the 51% limitation does not apply if the taxpayer files a transfer pricing study with its income tax return, including an analysis of the operations carried out in Puerto Rico. The transfer pricing study must be prepared in accordance with the requirements established in IRC Section 482 of the US Internal Revenue Code.

Under AD 21-05, the 51% limitation will not apply for tax years beginning 31 December 2018, if the deduction is based on a transfer pricing study that is issued and available when the income tax return is filed.

Additionally, AD 21-05 allows taxpayers to reasonably rely on a certified transfer pricing study for previous years, provided the taxpayer's facts and circumstances and relevant transactions in the tax year have not substantially changed since the certification of the transfer pricing study.

OECD developments

OECD reviewing options to roll back unilateral digital taxes

The OECD is considering how to roll back various unilateral digital taxes as the summer deadline for reaching a deal on the Base Erosion and Profit Shifting (BEPS) 2.0 Pillar One and Pillar Two proposals moves closer. Pascal Saint-Amans, the Director of the OECD's Centre for Tax Policy and Administration, in May 2021 was quoted as saying the organization will provide a framework of objective criteria by October 2021 to identify unilateral measures that are incompatible with Pillar One.

Saint-Amans said "we are confident that this is not too difficult a task," suggesting that there may be a list of offending regimes, although the framework will also ensure that countries do not introduce new digital taxes in the future. The framework is also reported to include a peer review mechanism to ensure that countries fulfill their commitments to withdraw relevant measures.

Saint-Amans further said that he expects there will be "significant agreement" reached on the BEPS 2.0 project at the G-20 and Central Bank Governors meeting on 8-9 July. But he cautioned that a final package that includes certain technical details, including an implementation plan that includes removal of unilateral digital services taxes – "and maybe some others" – also may not be completely ready until October 2021.

On the topic of cryptocurrency, Saint-Amans indicated that the OECD will publish updated common reporting standard (CRS) rules that address cryptoassets sometime in early 2022. Officials earlier had said an implementation package for a new cryptoasset framework would be delivered to the G20 later in 2021. Saint-Amans said the project, which is being delayed due to the focus on BEPS 2.0, is critical to avoid a "new black hole[s] emerging."

Parties to OECD MLI release interpretative opinion

The Conference of the Parties to the OECD Multilateral Instrument (MLI) recently approved an opinion that provides guidance on the interpretation and implementation of the MLI. The OECD reports that the MLI now currently covers 95 jurisdictions and has been ratified by 65 jurisdictions. The published opinions of the Conference of the Parties to the MLI are also available.

EY Member Firm US Tax Desks

Australia	Scott Hes, *Sydney*	scott.hes@au.ey.com
Canada	George Guedikian, *Toronto*	george.b.guedikian@ca.ey.com
	Emad Zabaneh, *Toronto*	emad.m.zabaneh@ca.ey.com
	Asif Rajwani, *Toronto*	asif.rajwani@ca.ey.com
	Ryan Coupland, *Calgary*	ryan.coupland@ca.ey.com
	George Tsitouras, *Montreal*	george.tsitouras@ca.ey.com
	Denis Rousseau, *Montreal*	denis.rousseau@ca.ey.com
	Richard Felske, *Vancouver*	richard.e.felske@ca.ey.com
China	Jeremy Litton, *Hong Kong*	jeremy.litton@hk.ey.com@hk.ey.com
	Lipeng He, *Shanghai*	lipeng.he@cn.ey.com
	Peter Kao, *Shanghai*	peter.kao@cn.ey.com
France	Paula Charpentier, *Paris*	paula.charpentier@ey-avocats.com
Germany	Thomas Day, *Munich*	thomas.day@de.ey.com
	Dmitri Bordeville, *Frankfurt*	dmitri.bordeville@de.ey.com
	Ann-Kristin Kautz, *Frankfurt*	ann-kristin.kautz@de.ey.com
	Lee-Bryan Serota, *Frankfurt*	lee.b.serota@de.ey.com
Israel	Amir Chenchinski, *Tel Aviv*	amir.chenchinski@il.ey.com
	Tal Levy, *Tel Aviv*	tal.levy@il.ey.com
	Itai Ran, *Tel Aviv*	itai.ran@il.ey.com
Japan	Joe Kledis, *Tokyo*	joe.kledis@jp.ey.com
Mexico	Alberto Lopez, *Mexico City*	alberto.r.lopez@mx.ey.com
	Manuel Solano, *Mexico City*	manuel.solano@ey.com
Singapore	Michael Xiang, *Singapore*	michael.xiang@sg.ey.com
Switzerland	Michael Parets, *Zurich*	michael.parets@ch.ey.com
UAE	Matt Berger, *Abu Dhabi*	matthew.berger@ae.ey.com
United Kingdom	Andrew Brown, *London*	abrown9@uk.ey.com
	Joseph Toce, *London*	jtoce@uk.ey.com
	Sean Trahan, *London*	sean.trahan@uk.ey.com
	Leif Jorgensen, *London*	ljorgensen@uk.ey.com
	Jillian Symes, *London*	jsymes@uk.ey.com

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