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Legislation

White House, Senate negotiators reach agreement on $1.2 trillion infrastructure package

The White House and bipartisan Senate negotiators on 28 July 2021 announced that they had reached agreement on a $1.2 trillion infrastructure package. The agreement was the culmination of months of talks among the parties.

The Senate later that day held a procedural vote to move forward on a bipartisan infrastructure bill (HR 3684); 17 Republicans voted in favor. The deal includes $550 billion in new federal spending, compared with the $578 billion figure initially agreed upon in June.

Based on a fact sheet released by the White House, pay-fors would include repurposing COVID relief funds, drug rebate rule delay, and a cryptocurrency tax compliance measure, among other items.

Senate Majority Leader Chuck Schumer (D-NY) indicated that his goal remained to pass both the bipartisan infrastructure bill and a budget resolution before the Senate adjourns for the August recess.

The Majority Leader on 29 July was also quoted as saying that Senate Democrats have the necessary 50 votes to move forward with a budget resolution, the first step in getting to a $3.5 trillion budget reconciliation bill this fall. The budget resolution would lay the groundwork for a "human infrastructure" budget reconciliation bill in the fall that would be paid for with corporate tax increases and major international tax changes, among other areas. Although it appears Democrats have the votes to pass the budget resolution, a group of moderate Senators have not committed to the size of the proposed package.

Digital news

OECD announces conceptual agreement in BEPS 2.0 project; endorsed by G20 Finance Ministers and Central Bank Governors

Most of the countries that make up the OECD's 139-member Inclusive Framework on 1 July 2021 endorsed a high-level BEPS 2.0 agreement that was two years in the making. The agreement addresses how the largest and most profitable multinational enterprises (MNEs) should allocate their taxable profits to customer jurisdictions under Pillar One of the OECD's project and a global minimum tax model that would ensure that MNEs pay a minimum level of tax, no lower than 15%, in all the jurisdictions in which they operate, under Pillar Two.

On 9-10 July 2021, the G20 Finance Ministers and Central Bank Governors met in Venice and endorsed the key components of the agreement. They also called on the Inclusive Framework to swiftly address the remaining issues, finalize the design elements within the agreed framework and provide an implementation plan for the two pillars by the October 2021 G20 Finance Ministers meeting.

The agreement provides that under Pillar One, countries that have digital sales taxes are committing to drop those levies when the agreement is implemented. "This package will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Service Taxes and other relevant similar measures on all companies," the statement says (here). The agreement on Pillar One includes relatively new metrics for determining the largest MNEs subject to a formulary approach for allocating their profits among jurisdictions and scoping in MNEs based on their revenues and profits, with explicit exclusions for financial services and extractive industries.

Under Pillar Two, Inclusive Framework members are committing to enact in their domestic laws a minimum tax on the foreign source earnings of MNEs headquartered in their countries, along with a backstop rule aimed at ensuring those companies pay the minimum level of tax even if the minimum tax itself, called the income inclusion rule, is not adopted. The endorsement of Pillar Two is a big win for the Biden Administration, which has been pushing for a global agreement in part to buttress support in Congress for its proposals to dramatically toughen the Global Intangibles Low-taxed Income (GILTI) rules.

The Inclusive Framework statement declares that "final decisions on design elements" of both Pillars should be agreed upon by October 2021. The statement released by the Inclusive Framework endorses an implementation plan for both Pillars. Under Pillar One, "The multilateral instrument through which Amount A is implemented will be developed and opened for signature in 2022, with Amount A coming into effect in 2023." Under Pillar Two, the implementation plan states that Inclusive Framework members should bring the Pillar Two rules into law in 2022, with application starting in 2023. The statement suggests a multilateral instrument could be used to coordinate implementation of Pillar Two.

OECD BEPS 2.0 multilateral convention and model legislation set for end of 2021, early 2022

The OECD plans to complete work on a multilateral convention and model domestic legislation by the close of 2021 or early next year in order for countries to begin to implement BEPS 2.0 Pillar One and Pillar Two in 2023. Pascal Saint-Amans, Director of the OECD's Centre for Tax Policy, made the comment during an OECD podcast on 16 July 2021. Saint-Amans said that the G20 Finance Ministers made clear that action must be taken quickly on implementation while there is political momentum.

He said during the podcast that Pillar One will shift $100 billion of profit from low-tax jurisdictions to jurisdictions "where the clients are," whereas Pillar Two (global corporate minimum tax) will generate $150 billion in revenue per year.

Treasury Secretary Janet Yellen released a statement (here) saying, in part, "Today's agreement by 130 countries representing more than 90% of global GDP is a clear sign: the race to the bottom is one step closer to coming to an end. In its place, America will enter a competition that we can win; one judged on the skill of our workers and the strength of our infrastructure. We have a chance now to build a global and domestic tax system that lets American workers and businesses compete and win in the world economy."

There were several countries that dissented from the IF agreement, including Ireland and Hungary.

Looking ahead, there is still significant work to be done in the Inclusive Framework to flesh out the technical details and address the remaining open issues. Beyond the October 2021 target for final agreement, the implementation process for each of the pillars will need to play out in countries around the world creating further complexity.

It is important for companies to follow these developments closely as they unfold in the coming months and to evaluate the potential impact of the proposed international tax changes on their businesses. In addition, looking ahead, companies will need to monitor activity in relevant countries related to the implementation of agreed rules through changes in domestic tax law and bilateral or multilateral agreements.

IRS news

Biden Administration expects increased IRS enforcement to generate more revenue

The Biden Administration is continuing to emphasize its focus on increased tax compliance and enforcement by citing a reduced tax gap as a funding source.

Since April 2021, President Biden has released several proposals about increasing IRS enforcement. The American Families Plan, released in April 2021, includes a proposal to increase investment in IRS enforcement to allow for greater focus on large corporations, businesses, estates and higher-income individuals.

On 28 April 2021, the Treasury Department issued a press release detailing the government›s plan to improve tax compliance by directing $80 billion in increased funding to the IRS over the next 10 years to: (1) improve technology; (2) increase the hiring and training of auditors to focus on complex investigations of large corporations, partnerships and global high-wealth individuals; and (3) increase enforcement against high-income individuals.

The Biden Administration's FY2022 budget and Treasury Green Book, released in May 2021, also focus on increased compliance and enforcement by, among other things, infusing the IRS with additional funding from FY 2022 through FY 2031.The proposal includes enhancing information technology capabilities, implementing the proposed financial information reporting regime and improving taxpayer service, as well as increased enforcement against those with incomes over $400,000.

If the funding increase is enacted, the IRS will add significant numbers of employees to its enforcement ranks, invest in technology and data analytics to detect noncompliance, and enhance risk assessment capabilities and mechanisms. Given the Administration's continued proposals and bipartisan support for increased IRS funding, taxpayers should consider doing a "health check" (i.e., examine their value chain to identify areas of risk around their current positions and consider any course corrections that might be needed to mitigate those risks going forward). Taxpayers may also want to assess benefits offered by Advance Pricing Agreements and other mechanisms that provide certainty so that they can focus their resources and attention on their business instead of potential tax issues.

US, UK competent authorities sign agreements re treaty LOB provision

United States and United Kingdom (UK) competent authorities on 26 July 2021 signed two arrangements regarding the interpretation of the terms "North American Free Trade Agreement (NAFTA)" and "resident of a Member State of the European Community" for purposes of the Limitation on Benefits (LOB) provision in the US-UK income Tax Treaty.

The first arrangement clarifies that the references to NAFTA in the LOB provision of the US-UK Treaty will be understood as references to 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). The second arrangement clarifies that a "resident of a Member State of the European Community" continues to include a resident of the UK for purposes of the derivative benefits test in the LOB provision of the US-UK Treaty.

The competent authorities of Switzerland and the United States entered into a similar arrangement in June 2020 regarding the interpretation of the term NAFTA in the US- Switzerland Treaty.

The two competent authority arrangements provide helpful guidance for interpreting the US-UK Treaty. Although the IRS and Treasury had previously announced that, once the USMCA enters into force, they will interpret references in US income tax treaties to the NAFTA as reference to the USMCA, the first arrangement confirms that the UK competent authority will similarly interpret references to the NAFTA as references to the USMCA. Likewise, the second arrangement puts an end to any uncertainty that may have existed with respect to defined terms in the US-UK Treaty as a result of the UK's withdrawal from the EU.

IRS memo addresses CSA and inclusion of stock-based compensation costs

In a generic legal advice memorandum (GLAM) the IRS Office of Chief Counsel (AM 2021-004) addressed its views on the treatment of stock-based compensation (SBC) costs in cost sharing agreements (CSA) that include a "reverse claw-back" provision, but do not share SBC costs (non-SBC CS agreements).

The IRS asserted that it can make certain allocations to make the cost sharing transactions consistent with an arm's length result. The IRS discussed how to treat those allocations for SBC costs and the timing of the adjustments.

More specifically, the IRS takes the position that SBC should be included in the cost pools under the cost sharing regulations. The IRS further asserts that it can adjust the results of a cost-sharing transaction (CST) in the year in which the intangible development costs (IDCs) were incurred under Reg. Section 1.482-7(i)(2) regardless of whether there is a reverse claw-back provision. In support of this position that it can ignore the terms of reverse claw-back provisions, the IRS asserts in the GLAM that excluding SBC would result in an imbalance between IDC shares and reasonably anticipated benefit (RAB) shares in any given year of exclusion.

In the GLAM, the IRS specifically addresses the following issues that may arise when the IRS makes the adjustment: (1) the correct year to include the SBC costs in the cost pool; (2) whether the adjustment affects the taxpayer's true-up obligation amount; and (3) whether the IRS can make an adjustment in a different year if it is unable to do so in the year the IDCs were incurred because the period of limitations on assessments has expired.

IRS issues early draft instructions for Schedules K-2 and K-3 for 2021 Forms 1065, 1120-S, and 8865

The IRS issued early draft instructions for amended Schedules K-2 (Partners' Distributive Share Items – International) and K-3 (Partner's Share of income, Deductions, Credits – International) for Forms 1065, 1120-S, and 8865 for tax year 2021 (filing season 2022). The drafts of the instructions offer a preview of what is coming before final versions are issued. The new Schedules K-2 and K-3 were released on 3 and 4 June 2021. 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 IRS concludes that under Reg. Section 1.482-7(i)(2) it may make allocations to adjust the results of a CST so that each controlled taxpayer's IDC share for each tax year is equal to its RAB share. The IRS argues that the allocation must be reflected for tax purposes in the year in which the IDCs were incurred. The IRS reasons in the GLAM that its allocations should be treated as reducing the amount of the taxpayer's reverse claw-back true-up obligation by a corresponding amount in order to avoid an overpayment of the SBC costs. The IRS further asserts in the GLAM that if the adjustments cannot be made in the year the IDCs were incurred, the IRS may make other adjustments in the year of the taxpayer's triggering event to reflect the contract or ensure that the non-SBC CS agreement produces results that are consistent with an arm's length result.

This GLAM is the second significant IRS administrative guidance concerning CSAs with SBC since the conclusion of *Altera v. Commissioner*. The IRS's positions set forth in the GLAM suggest that the IRS will likely continue to strongly pursue SBC inclusions under the 2003 SBC regulation. In addition, the GLAM shows that the IRS intends to make SBC adjustments in the years in which the IDCs were incurred regardless of the language contained in taxpayers' reverse claw-back provisions, and will revert to enforcing the terms of a reverse claw-back provision only if a year-by-year adjustment is unavailable. The IRS's positions in the GLAM are likely to be of interest to taxpayers.

While the GLAM may be relevant in evaluating the likelihood that the IRS may challenge a taxpayer's treatment of SBCs, it is not precedential authority for determining the level of comfort supporting a taxpayer's inclusion of SBC costs based on its facts and circumstances.

OECD releases another peer review on BEPS Action 14 dispute resolution

On 26 July 2021, the OECD released the [sixth batch of Stage 2 peer review reports] on the implementation by Argentina, Chile, Colombia, Croatia, India, Latvia, Lithuania, South Africa of the BEPS Action 14 minimum standard on dispute resolution. The outcomes of the Stage 2 peer review process demonstrate overall positive changes across most of the assessed jurisdictions.

Treasury official provides international tax regulatory update

A Treasury official in July 2021 was quoted as saying that final foreign tax credit regulations that will finalize proposed rules issued in the fall of 2020 will be released in two parts, with the first section expected to be released this year. The proposed regulations (REG-101657-20) on foreign tax credits provided rules that would fundamentally revamp how to determine the creditability of a foreign tax under Section 901 by requiring a foreign tax to meet a jurisdictional-nexus requirement (which would generally deny a credit for certain extra-jurisdictional taxes).

The initial release of the coming final regulations will contain the jurisdicational-nexus requirement, with certain other issues carved out for the second release.

Treasury and the IRS also reportedly will finalize this fall proposed regulations (REG-101828-19) under Sections 951, 951A, and 958 that were issued in June 2019. The proposed regulations provided new guidance on the treatment of Global Intangible Low-taxed Income (GILTI) and subpart F inclusions incurred through pass-through entities, as well as a GILTI high-tax exclusion.

The Treasury official was also quoted as saying that long-delayed previously-taxed earnings and profits (PTEP) regulations are still at least several months from release. He again confirmed that the regulations will be issued in several separate packages.

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