EY

Building a better working world

Washington Dispatch

August 2021, Volume 25, Issue 8

EY's weekly and monthly US international tax podcasts are available on iTunes and ey.com:

- Listen and subscribe to the weekly podcast on iTunes
- Listen and subscribe to the monthly podcast on iTunes
- Access all podcasts on EY's Tax News Update: Global Edition tool

In this issue

Legislation

Infrastructure legislation, FY'22 budget resolution move forward

The Biden Administration's and Senate Democrats' two-track policy to pass infrastructure legislation and an FY2022 budget resolution bore fruit in August. First, after months of negotiation, the Senate on 10 August approved (69-30) the *Infrastructure Investment and Jobs Act* (H.R. 3684), a bipartisan infrastructure package that would provide $550 billion in new spending that, combined with routinely authorized transportation funding, would cost $1 trillion over five years.

The bill makes investments in roads and bridges, broadband, water, and power (paid for with unused COVID funds), IRS cryptocurrency reporting (see below), pension smoothing, healthcare, and other provisions.

On 11 August, after a marathon 15-hour voting session, the Senate approved (50 to 49) the FY2022 budget resolution with reconciliation instructions (S. Con. Res. 14), clearing the way for the drafting of a $3.5 trillion package of Democratic priorities that can pass with a simple majority vote in the Senate.

The resolution sets revenue and spending targets for a budget reconciliation bill but does not prescribe policy details. Those details will be worked out by various Senate and House Committees within the confines of their reconciliation instruction targets. The Budget Resolution provides a target date of 15 September for the committees to submit their reconciliation legislation, though there is no penalty for missing the deadline.

In response to the Senate action, the House returned to Washington from its summer recess and adopted the Senate-passed FY2022 budget resolution on 24 August. The final House vote (220-212, along party lines) reflected a last-minute agreement among House Democratic leadership and House Democratic moderates that called for a vote on the trillion-dollar Senate-passed infrastructure bill by 27 September.

The House Ways and Means Committee will begin a markup the week of 6 September, which likely will last for a number of days.

The ultimate size of the proposed $3.5 trillion reconciliation bill is unclear at this time, with the amount of investments ultimately dictating the amount of pay-fors, including tax increases. Four general areas are targeted for potential investment: healthcare, energy, care-giving and education, and low-income tax credits. Pay-fors being considered by Democrats include corporate and international tax changes, individual tax increases targeting wealthier individuals, health and climate provisions – the latter including a possible polluter import fee – and dynamic scoring, which counts the macroeconomic effects of long-term growth in revenue calculations.

The House returns from the August recess on 20 September. The Senate returns to Washington on 13 September.

Senate Finance Committee Chairman, members release international tax discussion draft

On 25 August 2021, Senate Finance Committee Chairman Ron Wyden (D-OR), along with Senators Sherrod Brown (D-OH) and Mark Warner (D-VA), issued a discussion draft of legislative text (Discussion Draft) detailing their previously released April 2021 international tax framework, which would amend the current rules on global intangible low-taxed income (GILTI), foreign-derived intangible income (FDII), the Base Erosion and Anti-Abuse Tax (BEAT), and other rules.

The Committee Chairman noted earlier that the Wyden-Brown-Warner international tax framework would be among the proposals the committee would consider in developing a budget reconciliation package.

The Discussion Draft provides important details and the first draft of actual legislative text for potential changes to the US international tax system proposed by Chairman Wyden and other Democrats on the Senate Finance Committee.

Nevertheless, many practical and policy details remain to be determined, including the GILTI tax rate and how the BEAT might be changed to incorporate aspects of the Biden Administration's Stop Harmful Inversions and Ending Low-Tax Developments (SHIELD) proposal.

The Discussion Draft would:

- Establish a mandatory country-by-country high-tax exclusion system for GILTI, subpart F, and foreign branch income
- Potentially extend the foreign tax credit haircut (currently applicable in the GILTI context) to the subpart F and foreign branch income contexts

- Require certain research and experimentation and stewardship expenses to be allocated to US-source income
- Modify the rules for determining BEAT liability such that certain "base erosion income" would be subject to a different, and higher, rate
- Leave open the possibility that certain (currently undefined) modifications to BEAT may be made to incorporate the purposes and policies of the Biden Administration's SHIELD proposal
- Base the FDII regime on certain domestic innovation expenditures

The provisions are generally proposed to be effective for tax years beginning after the date of enactment with the notable exception of the modifications to FDII, for which no proposed effective date is provided.

Finance Committee Chairman introduces bill that would change tax treatment of financial derivative transactions

On 5 August 2021, Senate Finance Committee Chairman Ron Wyden (D-OR) introduced the *Modernization of Derivatives Act* (MODA), which would change the tax treatment of financial derivative transactions. Senator Wyden has previously introduced similar bills.

Financial derivatives instruments (Derivatives, as defined under MODA) are contracts that have a value based on underlying property or benchmarks. The most common types of Derivatives are options, forwards, futures, and notional principal contracts (NPCs or "swaps").

The current tax rules governing Derivatives were developed in a piecemeal fashion over time, in tandem with the development of new financial derivative instruments. This piecemeal development resulted in complex tax rules, which create tax-planning opportunities.

Given the patchwork design of applicable tax regimes, derivatives can be structured or combined to be economically similar to other types of derivatives but with different tax consequences.

The proposed legislation generally aims to replace many of the current statutes and regulations addressing the tax treatment of specific Derivatives with a new regime that uses one timing rule, one-character rule and one sourcing rule for all transactions. Under the proposed legislation, MODA would make the following changes to Derivatives:

- Require annual mark-to-market accounting for all transactions
- Treat all gains or losses from Derivatives and certain related assets as ordinary
- Determine the source of tax items based on the taxpayer's country of residence, incorporation or organization
- Introduce the Investment Hedging Units (IHUs) concept

Specifically, MODA would repeal Code Sections 1233, 1234, 1234A, 1234B, 1236, 1256, 1258, 1259 and 1260 (and associated regulations). In their place, MODA would add Section 491, Rules for Treatment of Derivatives; Section 492, Investment Hedging Units; Section 493, Derivative Defined; and Section 494, Tax Treatment of Contract Similar to Derivatives.

While the certainty of a unitary character and timing regime described in the MODA proposals may seem appealing, the definition of Derivative is quite broad and appears to include transactions not historically viewed as financial derivative transactions.

The broad scope of MODA would require newly affected taxpayers to: (1) develop and implement policies and systems to compute gain or loss that is based on valuations in the absence of a transfer or termination; and (2) comply with the annual mark-to-market requirement or determine the delta relationship between two positions for purposes of the IHU and revised straddle rules proposals under MODA.

Senate-passed infrastructure bill would impose information-reporting requirements on sales of cryptocurrency, other digital assets

Cryptocurrency and other "digital assets" sold by customers of "brokers" would be subject to Form 1099-B reporting and cost-basis reporting if the *Infrastructure Investment and Jobs Act* (the bill) becomes law. The bill, which passed the Senate on 10 August 2021, would amend the Internal Revenue Code to:

- Expand the definition of a broker
- Define "digital assets"
- Apply the cost-basis-reporting regime for securities to digital assets
- Require brokers to report the basis of digital assets transferred to their customers or other non-brokers to the IRS
- Require digital assets to be treated as "cash" when received in the course of a trade or business

The amendments would be effective for information returns filed in 2024 for the 2023 calendar year.

Given the considerable discussion in the Senate in regard to the crypto provision, there may be further efforts by Congress in the future to address a difficult-to-understand issue that is attracting increasing political heft.

IRS news

IRS extends to 1 January 2023, applicability date for W/H on certain transfers, distributions related to PTP interests

The IRS announced in Notice 2021-51 that it will amend the regulations under Section 1446(a) and Section 1446(f) to defer the applicability date of certain provisions by one year to 1 January 2023. The affected provisions relate to withholding: (1) on transfers of interests in publicly traded partnerships (PTPs), (2) on distributions made with respect to PTP interests, and (3) by non-publicly traded partnerships on distributions to transferees who failed to withhold properly.

Taxpayers may rely on the modified applicability dates immediately.

Section 1446(f) is a collection mechanism for Section 864(c)(8). It generally requires transferees purchasing interests in such partnerships from non-US transferors to deduct and withhold a 10% tax from the amount realized. The regulations on transfers of PTP interests require the tax to be withheld by the transferor's broker.

The IRS released final regulations (TD 9926) under Section 1446(f) in October 2020. The regulations originally were supposed to apply to withholding on certain transfers and distributions on and after 1 January 2022.

There are many unique challenges in implementing Section 1446(f) on PTP interest transfers, and the securities industry can put the additional time to good use. The extension also buys critical time for the IRS to complete additional guidance and for the industry to incorporate that guidance into its procedures.

US, Germany agree on exchange of CbC reports

The US and Germany reportedly agreed in July 2021 on implementation of spontaneous exchange of multinationals' country-by-country (CbC) reports for the period 1 January 2020 through 1 January 2021. The agreement is based on Article 26 of the 1989 US-Germany tax treaty, as amended in 2006.

The information that is exchanged reportedly will be subject to confidentiality and other safeguards found in the tax treaty, including the provisions that restrict the use of the exchanged information. According to the press, the parties are negotiating a competent authority arrangement to address the issue and the recent agreement is an interim measure.

Transfer pricing news

Amgen intends to challenge $3.6b tax deficiency

According to an Amgen Inc. (Amgen) executive, the pharma company plans to dispute a $3.6b tax deficiency assessed by IRS for tax years 2010, 2011 and 2012.

Amgen disclosed in its Form 10-Q that the IRS issued a notice of deficiency of $3.6b plus interest for tax years 2010, 2011 and 2012. The IRS also proposed significant adjustments to 2013, 2014 and 2015 tax years for similar issues. Amgen stated in the Form 10-Q that any additional tax that could be imposed would be reduced by up to $900m of repatriation tax previously accrued on foreign earnings.

IRS financial services campaign will not target specific transactions

An IRS official in August commented on the new IRS campaign aimed at financial service entities engaged in a US trade or business that was announced in June. She said the campaign will take a broad exploratory approach, not targeting specific types of transactions, and indicated that audit coverage in this area has been rare in the past. The IRS is in the process of reviewing returns to determine those which will be audited.

Amgen filed a petition in the US Tax Court to contest the notice but has not disclosed the specific legal issues in dispute. The Tax Court petition has not been made publicly available yet.

In a Q2 2021 earnings call on 3 August 2021, Amgen's executive vice-president and CFO Peter F. Griffith noted that the IRS notices are related to a transfer pricing dispute concerning the level of risk and functional complexity of the company's Puerto Rican office. According to Griffith, the dispute focuses on how the company allocates profits between the US and Amgen's manufacturing operations.

The case appears similar to *Medtronic, Inc. v. Commissioner*, which concerned cost-sharing arrangements between Medtronic and its Puerto Rican subsidiary. In 2016, the Tax Court held that aggregation is not the most reliable means of determining arm's-length consideration for controlled transactions if those transactions can exist independently; however, the Tax Court opinion was vacated by 8th Circuit Court of Appeals and remanded for further proceedings in the Tax Court.

The issuance of the deficiency notices in this case indicates that the IRS is not shying away from large and complex cross-border tax disputes. Given the recent increase in cross-border tax disputes, taxpayers may be well served by performing a health check on their transfer pricing. This includes examining their value chain, identifying areas of risk with respect to their current transfer pricing positions and being well prepared in the event of an IRS audit.

OECD developments

OECD releases 2021 update on peer review of preferential tax regimes

The OECD on 5 August 2021 released an update on the results of the peer reviews of jurisdictions' domestic laws under Action 5 (harmful tax practices) of the OECD/G20 BEPS Project. The results were approved on 7 June 2021 by the Inclusive Framework on BEPS.

The updated results cover 18 tax regimes. According to the press release, the total number of tax regimes that have been reviewed, or are under review, is 309. The reviews were undertaken by the Forum on Harmful Tax Practices and only one regime (Trinidad and Tobago) was classified to be "harmful." The rest of the regimes have been abolished, are in the process of being abolished, are being amended, are under review or are considered to be "not harmful." The Inclusive Framework will continue its reviews and will provide periodic updates.

The report notes that the United States has committed to abolishing its foreign-derived intangible income (FDII) regime.

The updated results of the review of preferential tax regimes underscore that the Inclusive Framework is continuing its focus on jurisdictions' implementation of the BEPS Action 5 minimum standard despite the ongoing global discussions on the BEPS 2.0 project. The release of the updated results provides information to taxpayers on the status of preferential regimes in jurisdictions in which they may operate.

OECD releases corporate tax statistics publication (third edition), including anonymized and aggregated CbC report statistics

On 29 July 2021, the OECD released the third edition of its annual Corporate Tax Statistics publication (the report) together with an updated database. The OECD describes the database as 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. The database includes anonymized and aggregated country-by-country (CbC) reporting statistics, reflecting information for the year 2017 and including information from CbC reports filed in 38 jurisdictions. 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 data as showing the importance of the two-pillar plan being advanced by member jurisdictions of the OECD/G20 Inclusive Framework on BEPS in connection with the so-called BEPS 2.0 project "to reform international taxation rules and ensure that multinational enterprises pay a fair share of tax wherever they operate."

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

prepared by Ernst & Young LLP's Washington International Tax Services summarizing recent developments and "inside-the-beltway" news pertinent to multinational companies. For additional information, please contact your local international Tax professional.

EYG no. 007323-21Gbl

1508-1600216 NY
ED None