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Legislation

Biden Administration's Build Back Better legislation stalls in Congress; Senate Finance Committee releases updated international tax provisions

On 19 December 2021, Senator Joe Manchin (D-WV) said on a Sunday morning news show that he would not support the proposed *Build Back Better Act*, ending consideration of the Biden Administration's marquee climate, tax, and spending proposals, at least for 2021. In a "Dear Colleague" letter that followed Sen. Manchin's announcement, Senate Majority Leader Chuck Schumer (D-NY) said the Senate would vote on a "modified version of the House-passed BBBA" early in the new year.

Before Senator Manchin's announcement, Senate Finance Committee Chair Ron Wyden (D-OR) had released on 11 December 2021, updated text of the Finance Committee's title of the *Build Back Better Act*. The updated text largely retained the international tax proposals from the version of the *Build Back Better Act* released on 28 October 2021 and later passed by the House (the House Bill), but included some significant technical changes to these rules.

The following discusses some of the highlights of the Finance Committee's updated international tax text.

Interest expense limitations

The Finance Committee proposal retains the basic structure of Section 163(n) from the House Bill, limiting deductions for net interest expense of a specified domestic corporation (SDC) to 110% of its net interest expense multiplied by the allowable percentage. The Finance Committee proposal maintains the same definition of SDC and international financial reporting group (IFRG), so Section 163(n) would continue to apply to foreign and US-parented multinationals alike.

Unlike prior iterations of Section 163(n), however, the committee proposal would permit taxpayers to elect to alter how the SDC's allocable share of the IFRG's book net interest expense (a component of the allowable percentage) is computed.

Subpart F and GILTI

The Finance Committee proposal retains, with no substantive modifications, the House Bill's overhaul of the global intangible low-taxed income (GILTI) rules, which would require a US shareholder to compute its GILTI amount on a country-by-country basis, among other things. The Committee proposal also retains the House Bill's changes to the subpart F income regime to generally limit foreign base company sales and services income rules to transactions involving a US tax resident, directly or by way of a branch or pass-through entity.

Consistent with the House Bill, the Committee proposal would, for both GILTI and subpart F income purposes, substantially revise the Section 951 pro rata share rules to address both a change in controlled foreign corporation (CFC) ownership during the year and dividends paid by the CFC during the year.

Dividends from foreign corporations

The House Bill would have limited the Section 245A deduction to dividends received from CFCs, whereas current law allows the deduction for dividends received from "specified 10%-owned foreign corporations" (STFCs). The Finance Committee proposal, in contrast, would allow a Section 245A deduction for dividends from STFCs that are not CFCs but would reduce the amount of the deduction from 100% of dividends received to 65% of dividends received. The Committee proposal would retain the election, included in the House Bill, to permit foreign corporations and their US shareholders to treat foreign corporations as CFCs.

The Committee proposal would also allow a CFC's US shareholder to claim a Section 245A deduction for its pro rata share of subpart F income that is attributable to eligible dividends received by the CFC from an STFC. Considering generally applicable exceptions from subpart F income, the deduction in most cases would equal 65% of the US shareholder's pro rata share of eligible dividends.

Foreign tax credits

The Committee proposal retains, with limited technical corrections, the House Bill's modifications to the foreign tax credit (FTC) rules, including a country-by-country FTC limitation for each separate category, the repeal of the foreign branch category, a GILTI category carryforward, a limitation on the allocation of expenses to the GILTI category for purposes of the FTC limitation, and other changes.

As discussed previously, the Committee proposal would limit the Section 245A dividends received deduction (DRD) to 65% (the applicable percentage under Section 243(a)(1) for a 20%-owned corporation of the foreign-source portion of a dividend received by a US shareholder from an SFTC that is not a CFC). Accordingly, the Committee proposal would amend Section 245A(d) to deny a credit or deduction for foreign taxes paid or accrued with respect to the applicable percentage for which the DRD is allowed.

The Committee proposal also includes a technical correction to the covered asset disposition rules, which would extend the principles of Section 338(h)(16) to transactions treated as asset dispositions for US tax purposes but as stock dispositions (or disregarded) for foreign tax purposes. Although intended to apply solely for FTC purposes, a cross-reference in the House Bill would apply the rule for purposes of all the Code's international income tax provisions.

BEAT

The Finance Committee proposal retains the general framework of Section 59A of the House Bill but would further modify the provision as it relates to COGS and payments with respect to inventory.

Under new Section 59A(d)(5) in the House Bill, the definition of base erosion payment would be expanded to include (i) certain indirect costs that are paid or accrued by the taxpayer to a foreign related party and are required to be capitalized to inventory under Section 263A, and (ii) certain amounts paid to foreign related parties for inventory to the extent the amounts exceed specified direct and indirect costs. The Finance Committee proposal would treat these amounts as base erosion tax benefits, which is relevant for determining modified taxable income and the base erosion percentage.

Corporate alternative minimum tax

Consistent with the House Bill, the Committee proposal would implement a new 15% corporate alternative minimum tax based on book income for companies that report over $1 billion in profits to shareholders. The Committee proposal introduces new adjustments for determining a taxpayer's adjusted financial statement income (the base to which the 15% rate would apply). Notably, taxpayers would disregard any book income, cost, or expense associated with a defined benefit plan.

Anti-inversion rules in Section 7874

The Finance Committee proposal would significantly expand the anti-inversion rules in Section 7874 by reducing the applicable continuing ownership thresholds and by expanding the types of acquisitions subject to these rules (which are known as "domestic entity acquisitions"). The House Bill did not include any expansion of Section 7874.

For the continuing ownership thresholds, the Committee proposal would treat a foreign acquiring corporation as a "surrogate foreign corporation" (potentially subjecting both the shareholders of the foreign acquiring corporation and the acquired domestic entity to adverse consequences) based on continuing ownership of more than 50% by vote or value (as compared to continuing ownership of at least 60% by vote or value under current law). It would also treat a foreign acquiring corporation as a domestic corporation based on continuing ownership of at least 65% by vote or value (as compared to at least 80% by vote or value under current law).

Treasury and IRS news

Treasury releases final foreign tax credit regulations

Treasury and the IRS on 28 December 2021 released final regulations (T.D. 9959) significantly restricting the ability to credit certain foreign taxes. The final regulations address a wide range of topics, including the definition of a foreign income tax, the disallowance of a credit or deduction for certain foreign income taxes, the allocation and apportionment of foreign income taxes, when foreign income taxes accrue, and related rules under the Internal Revenue Code.

Senate Foreign Relations Committee Republicans urge vote on 2010 US-Chile tax treaty

Eighteen Republican members of the Senate Foreign Relations Committee on 7 December 2021 sent a letter to the Chairman and Ranking Member of the committee urging the committee to hold a vote on the proposed 2010 US-Chile income tax treaty. The treaty has been stalled in committee for nearly 12 years and repeatedly stymied by Senator Rand Paul, who has blocked consideration of a number of pending US tax treaties – including the Chilean accord – due to privacy concerns. The senators wrote, "Without ratification of the Treaty, Chilean tax rates are due to increase on U.S. companies' Chilean operations and could reach a rate of 44.45 percent."

The final regulations follow the proposed regulations published on 12 November 2020, but include several notable changes. Highlights of the final regulations include the following:

- The final regulations overhaul the requirements that a foreign tax must satisfy to be claimed as a credit. The most significant change is that a foreign tax must satisfy a new "attribution requirement" (known as the "jurisdictional nexus requirement" under the proposed regulations) for the tax to be creditable under Sections 901 or 903. Under the attribution requirement, foreign taxes are not generally creditable unless the foreign tax law requires a sufficient nexus between the foreign country and the taxpayer's activities or investments. For example, a foreign tax may satisfy the attribution requirement if its sourcing rules are reasonably similar to US sourcing rules.
- The final regulations clarify the attribution requirement in several respects. When foreign law and US law characterize gross income or gross receipts differently, the final regulations provide that the foreign law characterization governs (except for the sale of a copyrighted article). This clarification should be particularly significant for cloud-computing and technology-enabled (including digital) transactions, which may be characterized as licenses under foreign law.
- The final regulations defer application of the attribution requirement to Puerto Rico's expanded effectively-connected-income regime and excise tax on certain goods and services. The attribution requirement applies to those taxes when they are paid or accrued in a tax year beginning on or after 1 January 2023. In contrast, the attribution requirement applies to other foreign income taxes when paid or accrued in tax years beginning on or after 28 December 2021.
- The final regulations follow the proposed regulations' rules for allocating and apportioning foreign income taxes imposed on (i) disregarded payments made between "taxable units;" (ii) dispositions of stock and partnership interests; and (iii) distributions by partnerships. Treasury rejected comments requesting a delayed applicability date for those provisions. Accordingly, those rules apply to tax years beginning after 31 December 2019 and ending on or after 2 November 220.
- The final regulations overhaul the proposed regulations under Section 245A(d), which disallow a credit or deduction for foreign income taxes attributable to "section 245A(d) income" and "non-inclusion income." As revised, the final regulations apply to a broader range of transactions than the proposed regulations, including certain remittances from a disregarded entity.
- Treasury declined to finalize certain provisions in the proposed regulations, including (i) an election to capitalize and amortize R&E and advertising expenditures for purposes of apportioning interest expense under Reg. Section 1.861-9 and (ii) rules addressing the allocation and apportionment of interest expense incurred by certain foreign bank branches.

Taxpayers should carefully consider how the new requirements for crediting a foreign tax, particularly the attribution requirement, affect their abilities to claim a credit for foreign taxes incurred. Many novel extraterritorial taxes, such as digital services taxes and equalization levies, whether or not creditable under prior law, are likely to fail the attribution requirement. But the scope of the final regulations is far broader, even though they were formulated in response to novel extraterritorial taxes. Many taxes that are less novel – particularly withholding taxes imposed on royalties and services – may not be creditable under the final regulations, particularly withholding taxes imposed in many emerging markets where there may be no double tax treaty relief. Those changes will have far-reaching implications for taxpayers across all industries.

The final regulations' rules on allocating and apportioning foreign income taxes are complex, and pose significant compliance challenges. Although the rules provide detailed guidance, difficult interpretational issues arise in many common scenarios. The rules can lead to surprising results, including the loss of foreign tax credits in certain cases.

IRS issues final rules on tax consequences of transition from LIBOR and other interbank offered rates in certain financial contracts

Treasury and the IRS on 30 December 2021 released final regulations (TD 9961) that provide guidance on the elimination of and pending transition away from the use of certain interbank offered rates (IBOR), including the London interbank offered rate (LIBOR), in certain financial contracts, including debt instruments, derivatives, and other contracts. The final regulations address whether a modification of the terms of a contract to replace an existing IBOR with a new reference rate results in a taxable event and the realization of income, deduction, gain, or loss.

FINCEN publishes proposed rules requiring entities to file reports on beneficial ownership

Treasury's Financial Crimes Enforcement Network (FINCEN) on 8 December 2021 published proposed regulations that would require certain entities to file reports with FinCEN regarding beneficial ownership, as required by the *Corporate Transparency Act*, which was enacted in January 2021. The purpose of the information reporting is to "help prevent and combat money laundering, terrorist financing, tax fraud, and other illicit activity." The proposed regulations address who must file, when they must file, and what information they must provide to the US Government.

The final regulations adopt, with certain changes, proposed regulations issued by Treasury on 9 October 2019, and incorporate, where relevant, additional guidance regarding recommended fallback language in certain financial contracts issued in Revenue Procedure 2020-44 on 9 October 2020.

Publication of all currency and term variants of LIBOR (with the exception of certain USD LIBOR tenors, and certain "synthetic" British sterling and Japanese yen LIBORs) ceased publication immediately following 31 December 2021. The publication of the overnight, one-month, three-month, six-month, and 12-month USD LIBOR is scheduled to cease immediately following 30 June 2023, and the publication of the "synthetic" LIBORs will continue until the end of 2022.

The recently released final regulations share many of the same fundamental rules as the proposed regulations. However, the structure of the final regulations differs significantly from the proposed regulations and is primarily intended to simplify the operative rules. For example, the proposed regulations separately state rules applicable to debt and non-debt contracts, whereas the final regulations contain a broad definition of a "contract," which includes not only debt and derivative instruments, but also insurance contracts, stock, leases, and other contractual relationships. In addition, the final rules make use of certain defined terms to streamline references to concepts frequently used in the operative rules. The term "covered modification" is the cornerstone of these rules and serves to restructure several of the fundamental rules set forth in the proposed regulations.

In one significant substantive change from the proposed regulations, the final rules replace the fair market value requirement under the proposed regulations with rules that describe specific modifications that are excluded from the definition of a covered modification (excluded modifications).

The final regulations, principally contained in Reg. Section 1.1001-6, apply to any modification of the terms of a contract that occurs on or after 7 March 2022. A taxpayer may choose to apply the final regulations to modifications of the terms of a contract prior to the applicability date, provided that the taxpayer and all related parties (within the meaning of Sections 267(b) or 707(b)(1)) apply the final regulations to all modifications of the terms of contracts that occur before that date.

The final regulations provide much-needed final guidance and clarity on most issues regarding the transition from and elimination of IBORs, including USD LIBOR. Despite the substantive structural changes to the rules, the thrust of the final rules is generally consistent with the guidance issued in the proposed regulations and Rev. Proc. 2020-44. As a result, taxpayers that have previously identified and modified IBOR-related contracts while adhering to that guidance may be able to retroactively apply the final regulations without adverse US tax consequences, as long as the rules are consistently applied.

FinCEN again extends certain signature authority reporting (FBAR, Form 114) over foreign financial accounts

In Notice 2021-1 (released 13 December 2021), the Financial Crimes Enforcement Network (FinCEN) further extended 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) regarding signature authority under Notice 2020-1 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 2020-1). Under the Notice, individuals have until 15 April 2023, to file deferred FBARs, subject to any potential further extension. Any persons not covered by the Notice for 2021 will have until 15 April 2022 – automatically extended six months to 17 October 2022 – to file their FBARs for the 2021 calendar year.

No extension (beyond the automatic six-month extension) is available for financial interest filing obligations.

OECD developments

OECD releases Model Rules on Pillar Two Global Minimum Tax

The OECD on 20 December 2021 released the Model Rules on the Pillar Two Global Minimum Tax, as approved by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS). The Model Rules cover the scope and mechanics of the Income Inclusion Rule and the Undertaxed Payments Rule, collectively referred to as the Global Anti-Base Erosion (GloBE) rules.

Together with the Model Rules, the OECD also released a summary of the rules (The Pillar Two Model Rules in a Nutshell), an overview of the key operating provisions of the GloBE rules (Fact Sheets) and a Frequently Asked Questions document.

The OECD press release indicates that it expects to release the Commentary relating to the Model Rules and to address the interaction with the United States (US) Global Intangible Low-Taxed Income (GILTI) rules in early 2022. In addition, the Inclusive Framework is developing the model treaty provision for the Subject to Tax Rule, which is the third element of the Pillar Two global minimum tax framework, and a multilateral instrument for its implementation, which the OECD expects to release in the early part of 2022 with a public consultation event on it to be held in March 2022. Finally, the OECD notes the work to be done on development of an implementation framework addressing administration, compliance and coordination matters related to Pillar Two and announces that a public consultation event on the implementation framework will be held in February 2022.

These Model Rules provide a substantial update to the Pillar Two Blueprint. Implementation of the Model Rules will lead to significant changes to the overall international tax rules under which businesses operate and will introduce new filing obligation that will require gathering additional data and adaption of companies' internal processes and systems.

It is important for companies to evaluate the potential impact of the proposed global tax changes and monitor activity in relevant countries related to the implementation of new rules through changes in domestic tax rules and bilateral and multilateral agreements, especially given the very ambitious implementation timeline. In particular, companies should monitor developments in the US with respect to the GILTI rules as well as the announced plans for implementation of Pillar Two in the European Union (EU) through an EU Directive.

OECD releases 2020 peer review report on BEPS Action 5 on the Exchange of Information of Tax Rulings

On 14 December 2021, the OECD released the fifth annual peer review report relating to compliance by members of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) with the minimum standard on BEPS Action 5 for the compulsory spontaneous exchange of certain tax rulings (the transparency framework).

The report covers 131 of the 141 current Inclusive Framework jurisdictions, including all jurisdictions that joined prior to 30 June 2020, and Jurisdictions of Relevance (i.e., jurisdictions that are outside the Inclusive Framework but are deemed to be of interest for the purposes of transparency in tax) identified prior to 30 June 2020.

The report assesses the 2020 calendar-year period and contains 66 recommendations for 36 jurisdictions to improve their legal or operational framework to identify and exchange tax rulings. Further, the report indicates that as of 31 December 2020, almost 22,000 tax rulings within the scope of the transparency framework had been issued by the jurisdictions under review, and over 41,000 exchanges of information had taken place.

This report is the first report for the peer review process on BEPS Action 5 conducted under the new transparency framework for the years 2021 through 2025 that was published on 22 February 2021.

While there are no signs that the Inclusive Framework intends to modify the Action 5 transparency standard, the European Commission intends to propose changes to the transparency framework in the European Union. According to a recently published Council report, in 2022 the Commission will table a legislative proposal on further revision of the Directive on administrative cooperation in the field of taxation (DAC), including proposals to cover tax rulings for wealthy individuals.

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