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BEPS 2.0

G20 confirms BEPS 2.0 ambitious timeline; Republican Senators voice concerns

The G20 Finance Ministers and Central Bank Governors in February re-endorsed the previously announced ambitious OECD/G20 Base Erosion and Profit Shifting (BEPS) 2.0 timeline, including, for Pillar One, having a final multilateral instrument, model rules for inclusion in domestic legislation, and a commentary completed by the middle of 2022. To meet this deadline, the OECD has released initial blocks of these rules as drafts for consultation purposes along with very quick turnaround deadlines for comments.

During a Tax Talks webinar on 21 February 2022, OECD officials discussed plans for future releases, but conceded that stakeholders have become increasingly frustrated with the rush to develop these rules. One official said, "we are trying to address them … with as much engagement as is possible within the overall timelines that we have."

BEPS 2.0 drafts have been released on nexus and revenue sourcing and tax base determinations for Amount A, and an OECD official said it is expected that other blocks of Pillar One will be released on a rolling basis once the scoping rules are "stabilized." (See OECD news below.)

OECD officials also provided an overview of the Pillar Two global minimum tax rules (or GloBE rules) that confirmed the basics of the rule – a 15% jurisdictional effective rate, assessed generally on a top-down approach. However, the ordering for the qualified domestic minimum tax (QDMT), newly released in the December 2020 Model Rules, was highlighted as a provision that would be applied first in determining the appropriate jurisdiction to which any top-up tax would be owed. Thus, if a jurisdiction adopts a QDMT, it will have the first right to collect tax, while a jurisdiction that adopts the income inclusion rule will have the right to collect tax (on a top-down basis) only when there is not a QDMT in a local jurisdiction. The undertaxed payments rule (UTPR) was identified as the third and last step in determining the jurisdiction to which tax could be owed but was not discussed.

An official also presented a Pillar Two timeline, saying the OECD is adding the finishing touches to the commentary and that it is expected to be released shortly. It appears that once the commentary is released, the OECD will turn to meet their goal of a February/March public consultation on implementation, with rules that are intended to deliver intended outcomes with a reasonable compliance burden, including safe harbors and simplified tax administration processes.

On the subject to tax rule (STTR), an OECD official presented the work streams as: (i) an STTR model treaty provision; (ii) a commentary; (iii) the process to assist in implementing; and (iv) a multilateral instrument. He said the OECD is developing a new multilateral instrument to facilitate implementation of the STTR in affected tax treaties, which is envisioned to be similar to the BEPS Multilateral Instrument and will modify the application of existing treaties to give effect to the rule. As identified in the October 2021 Inclusive Framework agreement, the STTR will apply to royalties, interest and other payments that remain under discussion.

Senate Democrats backburner Build Back Better, look to address inflation's impact

The US Senate in mid-February 2022 pivoted from discussions regarding the *Build Back Better Act* to what can be done to address inflation and who will support it. Senate Democrats reportedly plan to bring forward legislation in March that would reduce expenses for American households, with possible options that include a gas tax holiday and lowering the cost of prescription drugs.

Senate Majority Leader Chuck Schumer (D-NY) suggested that separate bills would be brought up, and not combined or attached to a legislative package.

Addressing the BEPS 2.0 negotiations, Republican Senate Finance Committee members wrote to Treasury Secretary Janet Yellen on 17 February, highlighting their concerns and underscoring the need for bipartisan discussions with Congress over the plan.

The Republican committee members wrote that the BEPS Pillar Two global minimum tax model rules released in December 2021 apply "far more broadly and adversely" to US companies than foreign competitors. According to the letter, other countries appear to have "negotiated more successfully to protect their domestic tax laws and companies" to receive exemptions from a global minimum tax. The Senators wrote: "It is one thing for the Administration to advocate for higher taxes as part of its domestic tax agenda, but quite another to explicitly negotiate an international agreement that would subject U.S. companies to double taxation unless Congress acts accordingly."

Treasury and IRS news

IRS releases FAQs on Schedules K-2 and K-3 transition relief

The IRS on 16 February 2022 released Frequently Asked Questions (FAQs) on transition relief for certain domestic partnerships and S corporations completing new Schedules K-2 and K-3.

Last month, the IRS outlined changes to previously issued IRS instructions for Schedules K-2 and K-3 for the 2021 tax year IRS Form 1065, *U.S. Return of Partnership Income*. Schedules K-2 and K-3 are new reporting forms that pass-through entities generally must complete, beginning in the 2021 tax year. According to the IRS, the new schedules K-2 and K-3 "improve reporting by standardizing international tax information to partners and flow-through investors, making it easier for them to report these items on their tax returns."

The latest FAQs on Schedules K-2 and K-3 provide details on additional transition relief to make it easier for those domestic partnerships and S corporations to change to and prepare the schedules. An exception for tax year 2021 to file the Schedules K-2 and K-3 for certain domestic partnerships and S corporations may be available if certain requirements are met. For more information see the IRS press release.

Many partnerships must complete Schedules K-2 (detailing partners' total international distributive share items) and issue Schedules K-3 (detailing a partner's share of international income, deductions, credits, etc.) to their partners to report US international tax information. Partners use the information reported on Schedule K-3 to complete their US tax and information returns.

The revised instructions released in January 2022 show how carefully all relevant facts must be weighed to determine whether, and to what extent, the Schedules K-2 and K-3 must be completed for partners. The changes provide more exceptions from filing, and additional clarity as to when such filing exceptions apply.

Treasury official briefs Senators on future cryptocurrency reporting regulations

In an 11 February 2022 letter to six Senators, the Treasury Assistant Secretary for Legislative Affairs wrote that future proposed regulations on cryptocurrency reporting requirements for brokers based on the recently enacted infrastructure legislation would be limited to those with access to certain information.

Last year's *Infrastructure Investment and Jobs Act* applied information reporting requirements to digital assets (including cryptocurrency) and updated the definition of broker to reflect the realities of how digital assets are acquired and traded, by adding to the definition "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."

The Treasury official wrote "ancillary parties who cannot get access to information that is useful to the IRS are not intended to be captured by the reporting requirements for brokers." As examples of who would not be covered by the proposed regulations, the official pointed to those "validating transactions through a consensus mechanism" as well as individuals "selling storage devices used to hold private keys or persons who merely write software code." Treasury will study the extent to which others in the digital asset market, including centralized exchanges, decentralized exchanges and peer-to-peer exchanges should be treated as brokers, the official said.

OECD developments

OECD releases Pillar One public consultation document on draft nexus and revenue sourcing rules

On 4 February 2022, the OECD Secretariat released a public consultation document with draft rules on nexus and revenue sourcing in connection with Pillar One of the OECD/G20 BEPS 2.0 project.

Pillar One involves the development of new nexus and profit allocation rules that assign a greater share of the taxing rights over global business revenue to the market jurisdictions. These new nexus rules are intended to apply solely for purposes of determining whether a jurisdiction qualifies for profit re-allocation under Amount A of Pillar One and are not intended to affect the nexus determination for any other tax or non-tax purpose.

Under the draft model rules included in the consultation document, nexus in a particular jurisdiction is determined based solely on revenue arising there and revenue is to be sourced on a transaction-by-transaction basis using a reliable indicator or, as a back-stop, a specified allocation key. Different sourcing rules, indicators and allocation keys are provided for the different categories of revenue that are identified in the draft rules (e.g., sale of finished goods, advertising services).

The consultation document includes footnotes describing the further explanation that will be provided in the commentary that will support the model rules.

The consultation document indicates that it is a working document released to obtain input from stakeholders. The release of the document does not reflect consensus of the Inclusive Framework member jurisdictions on the substance of the document.

Application of the draft model rules would have significant implications for companies that are in scope of Pillar One Amount A, including with respect to the development or adaptation of information systems, and could create substantial uncertainty.

OECD releases Pillar One public consultation document on draft rules for tax base determinations

On 18 February 2022, the OECD Secretariat released a public consultation document with draft rules for tax base determinations under Amount A for Pillar One of the OECD/G20 BEPS 2.0 project.

Pillar One involves the development of new nexus and profit allocation rules that assign a greater share of the taxing rights over global business profits to the market jurisdictions. This is done through a formulaic approach, by first determining the global profits of the group and then allocating a portion of these profits to the market jurisdictions by using a revenue-based formula. The tax base determines the total profits of a group to which the formula will be applied. The starting point for this determination is the consolidated group financial accounts. The draft rules provide specifics on the calculation of the tax base, including book-to-tax adjustments, treatment of restatements, carryforward of losses and taking into account changes in the group structure.

The consultation document includes footnotes describing the further explanation that will be provided in the commentary that will be issued to support the model rules.

The consultation document indicates that it is a working document released to obtain input from stakeholders and does not reflect consensus of the Inclusive Framework member jurisdictions on the substance of the document.

OECD finalizing crypto reporting framework

An OECD official was quoted in February as saying the organization is finalizing a tax reporting framework for cryptoassets. The official said, "The goal of the OECD work is to design a tax reporting exchange framework that will allow tax administrations to obtain and then automatically exchange the relevant information, which is needed to address tax compliance risks ... ." The OECD will publish the framework plan, reportedly including proposed revisions to the common reporting standard, in March 2022.

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