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Legislation

Biden Administration releases FY2023 Budget with several new international tax proposals

The Biden Administration released the FY2023 Budget on 28 March, including major tax proposals some of which were previously floated by the Administration or congressional Democrats and others that are new. Treasury also released the General Explanation (Greenbook) available [here](#). The Budget folds most of the House-passed *Build Back Better Act* (BBBA) into the baseline and assumes it has been enacted.

The Budget continues to call for tax provisions that fell out of the House-passed *Build Back Better Act* due to opposition in Congress, including:

- ▶ Raising the corporate tax rate to 28%
- ▶ Increasing the top marginal income tax rate (to 39.6%) for high earners
- ▶ Reforming the taxation of capital income to tax capital gains of high earners at ordinary income rates
- ▶ Taxing carried interests as ordinary income
- ▶ Repealing deferral of gain from like-kind exchanges

As in last year's budget, the proposal to reform the taxation of capital income would tax long-term capital gains and qualified dividends of taxpayers with taxable income of more than \$1 million at ordinary rates, with 37% generally being the highest rate (40.8% including the net investment income tax).

The Budget also includes a new "billionaire's tax" that received considerable attention. The proposal would impose a 20% minimum tax on total income, inclusive of unrealized capital gains, for taxpayers with wealth of greater than \$100 million. (Senator Joe Manchin (D-WV) said the next day that he did not support the "billionaire tax" proposal, which means the measure would have great difficulty passing the evenly-split Senate.)

The Budget includes seven proposals that focus on reforming business and international taxation that are estimated to raise \$1.628 trillion over 10 years.

Corporate rate and GILTI

The Budget proposes to increase the 21% corporate rate to 28%, which would consequently increase the global intangible low-taxed income (GILTI) rate in tandem. The new GILTI effective rate would be 20%, applied on a jurisdiction-by-jurisdiction basis. The proposal would be effective for

tax years beginning after 31 December 2022. For tax years beginning before 1 January 2023, and ending after 31 December 2022, the corporate income tax rate would equal 21%, plus 7% times the portion of the tax year that occurs in 2023.

BEAT repealed and replaced with UTPR

The proposal would repeal the base erosion and anti-abuse tax (BEAT) as modified by the BBBA and replace it with an undertaxed payment rule (UTPR) that is consistent with the UTPR described in the OECD Pillar Two Model Rules, including a global annual revenue threshold (\$850 million), de minimis exclusions and allocation among jurisdictions. Further, a US domestic minimum top-up tax would be part of the rules to protect US revenues from the imposition of UTPR by other countries.

The proposal expressly notes: "Separately, the proposal would provide a mechanism to ensure U.S. taxpayers would continue to benefit from U.S. tax credits and other tax incentives that promote U.S. jobs and investment." It is not clear, however, how those benefits would be preserved.

The UTPR would primarily apply to foreign-parented multinationals operating in low-tax jurisdictions and would not apply to income subject to the BEPS 2.0 Pillar Two Income Inclusion Rule (IIR), including income subject to GILTI. Both domestic corporations that are part of a foreign-parented multinational group and domestic branches of foreign corporations would be disallowed US tax deductions in an amount determined by reference to the low-taxed income of foreign entities and foreign branches that are members of the same financial reporting group (including the common parent of the financial reporting group).

The proposal to repeal the BEAT and replace it with the UTPR would be effective for tax years beginning after 31 December 2023.

Incentive to bring jobs to the US

A new general business credit would equal 10% of the eligible expenses paid or incurred in connection with onshoring a US trade or business that is linked to reducing or eliminating a trade or business or line of business currently conducted outside the United States or starting up, expanding, or otherwise moving the same trade or business within the United States, to the extent that this action results in an increase in US jobs. Deductions would be disallowed for

expenses paid or incurred in connection with offshoring a US trade or business, including denying deductions against a US shareholder's GILTI or subpart F income inclusions for any expenses paid or incurred in connection with moving a US trade or business outside the United States.

The proposal, which was reprised from the FY2022 Budget but never really part of the public BBBA discussion, would be effective for expenses paid or incurred after the date of enactment.

The President's FY2022 Budget proposed to repeal the deduction for foreign-derived intangible income (FDII) on the grounds that it encourages offshoring of US businesses and jobs. That proposal is not included in the FY2023 Budget, even though it is not part of the BBBA.

Other business and international tax proposals

Other proposals to reform business and international taxation include:

- ▶ Disallowing stepped-up basis of a partnership's non-distributed property to a related partner until the property is disposed. The proposal would be effective for partnership tax years beginning after 31 December 2022.
- ▶ Conforming the definition of control to test the ownership of at least 80% of the total voting power and at least 80% of the total value of a corporation's stock. The proposal would be effective for transactions occurring after 31 December 2022.
- ▶ Expanding the retroactive election for those having an interest in a passive foreign investment company that is intended to reduce tax costs and increase tax compliance by removing, in certain cases, the need to seek consent. The proposal would be effective on the date of enactment. Forthcoming regulations or other guidance would permit taxpayers to amend previously filed returns for open years.
- ▶ Amending reporting obligations of US persons to provide information on foreign operations that would align with BBBA changes, for example, that would focus on foreign operations conducted by tested units within a country as opposed to the current definition of a foreign business entity that could allow blending across jurisdictions that the BBBA would remove.

Another related provision in the Budget would expand existing rules on financial account reporting to include reporting on the account balance (including the cash value

or surrender value of cash-value insurance and annuity contracts) for all US office accounts of foreign persons and includes new reporting for other financial accounts held by foreign persons.

The Budget further seeks to modernize rules for reporting on digital assets, including cryptocurrency, primarily by adding these types of assets to the scope of existing reporting requirements.

These provisions include amending the nonrecognition rules for securities loans to apply to loans of actively traded digital assets; increasing information reporting by certain financial institutions and digital asset brokers for purposes of exchanging information with other jurisdictions; requiring reporting by taxpayers of foreign digital asset accounts under Section 6038D; and amending the mark-to-market rules for dealers and traders to include digital assets.

Congress passes omnibus appropriations bill with no tax title; Democrats still hope for reconciliation package

The US Congress in March 2022 passed a long-negotiated \$1.5 trillion, 2,741-page omnibus appropriations bill that does not include a tax title, meaning it does not address any tax extenders or *Tax Cuts and Jobs Act* cliffs. The spending bill will fund the Federal Government through the remainder of FY2022. President Biden signed the law on 15 March 2022.

Senate Finance Committee Chairman Ron Wyden (D-OR) had said there likely would not be a tax section in the Omnibus bill because some Democrats did not want to act on corporate tax provisions without items for individuals such as extending the expanded Child Tax Credit with monthly payments.

In regard to a post-*Build Back Better Act* reconciliation bill and other aspects of the congressional agenda, Senate Majority Leader Chuck Schumer (D-NY) released a letter on 7 March, saying that during March and April "many Senate committees will hold new hearings and mark-ups on Democrats' cost-cutting proposals." In regard to reconciliation specifically, the Majority Leader wrote that "Senate Democrats have introduced additional legislative proposals to lower the rising cost of energy, prescription drugs and health care, and the costs of raising a family." The letter was seen by some as the first signal by Senate Democrats that they planned to bring forward a social spending and climate reconciliation package that is more in line with recent statements by Senator Joe Manchin (D-WV).

To that end, Senator Manchin reportedly has restarted discussions with colleagues in regard to developing a limited reconciliation bill that would focus on climate change, prescription drugs, reducing the debt and tax changes. According to multiple reports, Senator Manchin wants to negotiate a compromise and believes that a vote should take place before the August congressional recess.

Senator Manchin reportedly would support approximately \$500 billion for climate change and \$1 trillion in new revenue. There is no mention that the Senator would support new or enhanced social spending programs in the pared down bill.

Senate Finance Committee Chairman supports tax sanctions for Russia, Belarus

Senate Finance Committee Chairman Ron Wyden (D-OR) in March 2022 issued a press release indicating he supports putting Russia and Belarus on the list of countries subject to Section 901(j) sanctions. Code Section 901(j) eliminates the preferential 10.5% GILTI (global intangible low-taxed income) tax rate and disallows foreign tax credits for income earned in countries that support terrorism or without US diplomatic relations. Chairman Wyden's proposal would put countries that are participating in or materially support the invasion of Ukraine on the list of countries subject to the sanction.

This latest proposal follows President Joe Biden's revocation of most favored nation status for Russia and some talk on Capitol Hill of terminating the US-Russia tax treaty.

Treasury and IRS news

Final FTC regulations will be revisited to address BEPS 2.0 Pillar Two rules

A US Treasury official in March was quoted as saying the government will consider whether US foreign tax credits would be available for qualified domestic minimum top-up taxes related to the OECD BEPS 2.0 Pillar Two rules once more guidance becomes available. The official noted that the recently released final foreign tax credit regulations do not explicitly address Pillar One or Pillar Two. But "as the pillars are getting implemented, we will have to reopen those regs," he said.

While the Pillar Two commentary released in March 2022 is explicit that countries should not provide foreign tax credits for taxes paid under the Income Inclusion Rule and the Undertaxed Payment Rule, the issue is less clear for qualified domestic minimum top-up taxes. The Treasury official elaborated that "it's something that we're going to have to study and look at, whether there should be a credit for qualified domestic minimum top-up tax, and it will depend on how they're implemented."

Earlier, an IRS official provided some insights into the final foreign tax credit regulations. He was quoted as saying that in a situation where a foreign jurisdiction divides a royalty into two parts based on payor location and the location of the use of the intellectual property, withholding tax on the portion based on the payor location may not be eligible for a US foreign tax credit. The IRS official said in this situation, no foreign tax credit would be available because the payor jurisdiction designation is not reasonably similar to US rules and does not meet the final regulations' attribution requirement.

President Biden pitches BBB measures in first State of the Union

President Joe Biden gave his first State of the Union address on 1 March 2022 during which he called on Congress to enact many of the individual provisions of his proposed Build Back Better (BBB) plan, although not mentioning BBB by name. The President tried a different approach given the country's current economic climate, making the argument that the provisions would reduce inflation by lowering costs and lowering the deficit.

The President also targeted tax fairness, saying the administration would work to close what he called corporate tax loopholes. "The one thing all Americans agree on is that the tax system is not fair. We have to fix it." He also made a pitch for a 15% minimum corporate tax rate.

IRS official recommends all taxpayers request fast-track PLRs

An IRS official in March 2022 recommended that taxpayers should always request the new fast-track private letter ruling (PLR) process that was announced in January 2022 in Rev. Proc. 2022-10, saying there is no down-side. The IRS instituted the 18-month pilot program to address corporate PLR requests, with a target completion of 12 weeks from assignment to an agency review team.

Proposed PTEP regulations coming second half of 2022

A Treasury official in March 2022 confirmed that the Government is committed to releasing long-awaited proposed previously-taxed earnings and profits (PTEP) regulations in 2022 that will address multiple areas, but that taxpayers should not expect their release until the latter half of the year. An IRS official was also quoted as saying, however, that the coming PTEP regulations would not include rules on capital accounts “especially as [they] relate to GILTI.”

Tax treaties

Senate Foreign Relations Committee reports out proposed US-Chile tax treaty

The US Senate Foreign Relations Committee on 29 March 2022 approved the long-delayed US-Chile income tax treaty. The proposed treaty next goes to the full Senate which must give its advice and consent to ratification of the treaty with a two-thirds majority vote. Once the Senate takes action to approve the treaty, the President must sign the instruments of ratification to complete the approval and ratification process in the United States.

The Chilean government in 2015 undertook the steps necessary for the treaty to be approved in Chile. The treaty will enter into force when all applicable approval procedures in the United States and Chile have been satisfied.

The Foreign Relations Committee approval was subject to two reservations concerning the base erosion and anti-abuse tax (BEAT) and Article 23 (Relief from Double Taxation). The reservation concerning BEAT clarifies that the treaty shall not prevent the imposition of BEAT under Section 59A.

The treaty was signed on 4 February 2010 (along with a protocol) and was reported on favorably by the Senate Foreign Relations Committee in 2014, and again in 2015. A vote was considered in 2019, but never materialized.

Significant provisions of the proposed treaty include:

- ▶ Reduced withholding tax rates on dividends, interest and royalties
- ▶ The allowance of a withholding tax on the sale of certain stock
- ▶ A permanent establishment (PE) provision that deems a PE to exist from the provision of services under certain circumstances, and in cases where an installation used for on-land exploration of natural resources lasts for more than three months
- ▶ A limitation-on-benefits provision that includes a “headquarters company test” and a triangular provision
- ▶ Provisions providing for exchange of information between the tax authorities of the United States and Chile
- ▶ Rules that source interest and royalty income to the residence of the payor or, alternatively, if the payor has a PE in connection with which the liability to pay interest or royalties was incurred, then to the location of the PE
- ▶ A place-of-use test for sourcing royalty income in cases where the residence of the payor and the PE rules described previously do not apply

If the treaty is ratified, the withholding provisions would become effective for amounts paid or credited on or after the first day of the second month following the date on which the treaty enters into force. For all other taxes, the provisions would take effect for tax periods beginning on or after the first day of January following the date the treaty enters into force.

US, Croatia treaty talks in final stage

US and Croatian officials met in Washington on 17 March 2022 for a “strategic dialog.” In a [joint statement](#), the two governments expressed satisfaction with reaching a final stage of tax treaty negotiations and affirmed their commitment for a “swift conclusion of a treaty.”

OECD developments

OECD releases Commentary and illustrative examples on Pillar Two Model Rules

The OECD on 14 March 2022 released the Commentary to the Pillar Two Model Rules (the [Commentary](#)) as agreed by the OECD/G20 Inclusive Framework on BEPS. The Pillar Two Model Rules, released on 20 December 2021, define the scope and key mechanics for the Pillar Two system of global minimum tax rules, which includes the Income Inclusion Rule (IIR) and the Under Taxed Payments Rule (UTPR), referred to collectively as the “GloBE rules.”

The 228-page Commentary references the role of the Model Rules and the Commentary in the context of the GloBE rules’ status as a Common Approach, noting the need for consistency in the implementation and administration of the rules to avoid the risk of double or over-taxation.

The Commentary provides detailed technical guidance on the operation and intended outcomes of the Model Rules and clarifies the meaning of certain terms. It also illustrates the application of the rules to various fact patterns. Together with the Commentary, the OECD also published a separate 50-page document with illustrative examples of the application of the Model Rules (the [Examples document](#)).

The commentary reconfirmed that there could be a top-up tax allocable under the Undertaxed Payments Rule (UTPR) when domestic income earned by a company in its headquarter jurisdiction has an effective tax rate as computed under the Pillar Two model rules that is below 15%. This has raised concerns among many US companies that avail themselves of incentives and credits that are not qualified refundable credits as defined in the model rules under Pillar Two. In effect, this could mean that a top-up tax may be payable in other jurisdictions because certain credits and incentives were utilized in the US.

The OECD indicated that the next step in regard to the GloBE Rules will be development of the Implementation Framework,” as agreed under the Detailed Implementation Plan set out in the [October Statement](#).”

On the same date, the OECD also announced a public consultation through 11 April 2022 in connection with the work to be done next to develop the GloBE Implementation Framework addressing administration, compliance and coordination matters related to Pillar Two (the [public consultation](#)). The Inclusive Framework members are seeking public input on the issues that should be addressed as part of this work.

In the coming weeks the OECD plans to release a model treaty provision for the Subject to Tax Rule (STTR), supplemented by Commentary that explains the purpose and the operation of the rule, and a Multilateral Instrument for STTR implementation. The OECD also has indicated the intention to hold a public consultation on the STTR.

The Model Rules and lengthy Commentary underscore the complexity of the global minimum tax rules and the significant resource investment that companies that are in scope of the new rules will need to make in order to be ready to comply when the new rules take effect. As noted earlier, the Inclusive Framework is working to develop the GloBE Implementation Framework to provide guidance on coordination, administration and compliance matters with respect to the Pillar Two global minimum tax.

However, the GloBE Implementation Framework may not be released until late in 2022. The public consultation meeting that the OECD will hold in April 2022 may provide some information regarding the administration and compliance mechanisms being considered. Given the current timeline, businesses may need to start preparing for compliance with the new global minimum tax rules before the final implementation framework is released.

OECD begins public consultation on crypto-asset reporting, CRS

The OECD on 22 March 2022 initiated a [public consultation](#) titled “Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard” (CRS). The public consultation will run through 29 April. The OECD is developing a global tax transparency framework that would provide for standardization of automatic exchange of information regarding crypto-asset transactions. The OECD is also proposing amendments to the Common Reporting Standard to bring crypto-assets into scope. Finally, the OECD announced plans to launch a comprehensive review of the CRS to improve its operation.

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