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In this issue

Legislation

2. President Biden signs Inflation Reduction Act with 15% corporate minimum tax

3. Congress passes $280 billion Chips and Science Act

IRS news

3. Applicability date for foreign currency regulations under Section 987 extended again

4. IRS announces delay in effective date of Section 871(m) regulations

Transfer pricing news

4. Tax Court increases Medtronic royalty rate under unspecified TP method

5. Increased IRS funding from Inflation Reduction Act may increase scrutiny of transfer pricing cases

OECD developments

5. OECD releases 2022 update on peer review of preferential tax regimes and no or only nominal tax jurisdictions

Legislation

President Biden signs Inflation Reduction Act with 15% corporate minimum tax

On 16 August 2022, President Joe Biden signed into law the *Inflation Reduction Act of 2022* (the Act) passed earlier in the month by Congress. The legislation includes over $430 billion in climate and energy provisions and an extension of enhanced *Affordable Care Act* (ACA) subsidies. It includes offsets of more than $700 billion in revenue by:

- Imposing a 15% corporate alternative minimum tax (CAMT) on adjusted financial statement income for corporations with profits over $1 billion
- Introducing a new one percent excise tax on corporate stock buybacks
- Increasing IRS enforcement funding
- Reforming prescription drug pricing, including allowing Medicare to negotiate prescription drug prices

15% minimum tax and applicable corporations

An applicable corporation is liable for the CAMT to the extent that its "tentative minimum tax" exceeds its regular US federal income tax liability plus its liability for the base erosion anti-abuse tax (BEAT). An applicable corporation's tentative minimum tax is a 15% minimum tax on its adjusted financial statement income (AFSI) to the extent it exceeds the CAMT foreign tax credit for the tax year. The CAMT applies to any corporation (other than an S corporation, regulated investment company, or real estate investment trust) whose average annual AFSI exceeds $1 billion for any three consecutive tax years preceding the tax year.

The Act adds new Section 56A, which defines "adjusted financial statement income" of a corporation (taxpayer) as the taxpayer's net income or loss reported in the taxpayer's applicable financial statement – as defined in Section 451(b)(3) – with adjustments for certain items.

For a corporation that is a member of a foreign-parented multinational group, the three-year average annual AFSI must be (1) over $1 billion from all members of the foreign-parented multinational group, and (2) $100 million or more of income from only the US corporation(s), a US shareholder's pro rata share of controlled foreign corporation (CFC) AFSI, effectively connected income and certain partnership income.

A foreign-parented multinational group means two or more entities if (i) at least one entity is a domestic corporation and another is a foreign corporation; (ii) the entities are included in the same applicable financial statement; and (iii) the common parent of those entities is a foreign corporation (or the entities are treated as having a common parent that is a foreign corporation).

The CAMT will apply to tax years beginning after 31 December 2022.

Three-tax-year period

The three-tax-year period means any three consecutive tax years preceding the tax year in which the tax applies (beginning with three-tax-year periods in which the third year of the period ends after 31 December 2021).

Exceptions

The CAMT does not apply to corporations that have either changed ownership or fallen below the AFSI threshold for a specified number of consecutive years (to be determined by Treasury), conditioned upon the Treasury also determining that it would be inappropriate to continue subjecting the corporation to the tax. The exception no longer applies if the corporation meets the three-year average AFSI test for any tax year beginning after the year for which the determination applies.

The Act will require applicable corporations to compute two separate calculations for federal income tax purposes and pay the greater of the CAMT or their regular tax liability (regular tax liability plus BEAT liability). Companies should assess their structures to identify applicable corporations, taking into account the special rules for common employer groups and foreign-parented multinational groups.

Comprehensive modeling can help applicable corporations consider and plan for any potential increase in their federal income tax liability. Modeling is especially critical post-TCJA given the many complicated and interrelated foreign and domestic tax provisions that can affect a corporation's tax liability, including the CAMT, BEAT, 163(j), foreign derived intangible income (FDII), global intangible low-taxed income (GILTI) and BEPS Pillar Two.

Climate and energy provisions

Embedded in the *Inflation Reduction Act* is $369 billion in climate and energy-related provisions, which are designed to: (i) incentivize and accelerate the buildout of renewable energy; (ii) advance the adoption of EV technologies; and (iii) improve the energy efficiency of buildings and communities.

Inflation Reduction Act includes one percent stock buyback excise tax

The *Inflation Reduction Act of 2022* (H.R. 5376) includes an excise tax that imposes a surcharge on corporate stock buybacks. The provision adds a new Section 4501 to the Code, which would impose a 1% excise tax on publicly traded US corporations for the value of any of its stock that is repurchased by the corporation during the tax year. The stock buyback provision applies to repurchases of stock after 31 December 2022.

The term "repurchase" is defined broadly, and so the tax could apply not only to redemptions under stock repurchase program but a range of corporate transactions. Publicly traded corporations considering redemptions or economically similar transactions therefore should consider its potential application after that date and possible action before that date.

Many of the Act's provisions with respect to energy transition and renewable energy investments are expected to spur development and investment; however, the new rules can be very complex, and it is important for taxpayers to understand the rules and how they apply to their particular projects.

Congress passes $280 billion Chips and Science Act

The US Congress passed and President Biden on 9 August 2022 signed into law the *CHIPS and Science Act* (HR 4346). The legislation provides $280 billion to build a domestic US supply chain for semiconductor chips in the face of foreign competition, while also spending billions on scientific and technological research to keep US industries competitive with China and other rivals.

CHIPS, which stands for *Creating Helpful Incentives to Produce Semiconductors*, includes $52.7 billion in funding for semiconductor manufacturing subsidies, grants and loans. Most of the money ($50 billion) is dedicated over five years to a CHIPS for America Fund that will implement incentives issued by the Commerce Department to "develop a domestic manufacturing capability, and research and development and workforce development programs authorized by the FY21 *National defense Authorization Act* (NDAA)," according to a staff summary.

The legislation also includes a 25%" advanced manufacturing investment credit" for investments in semiconductor manufacturing and includes incentives for the manufacturing of semiconductors, as well as for manufacturing of specialized tooling equipment required in the semiconductor manufacturing process, with taxpayers allowed to treat the credit as a payment against tax (direct pay).

Recipients of the semiconductor incentive funds will be subject to certain restrictions.

The science and research provisions notably authorize $102 billion over five years for the National Science Foundation (NSF), the Commerce Department and the National Institutes of Standards and Technology to increase investments in R&D. The bill also focuses on STEM education from pre-K through high school, among other science provisions.

IRS news

Applicability date for foreign currency regulations under Section 987 extended again

The IRS on 15 August 2022 announced (Notice 2022-34) that it intends to defer by one more year the applicability date of certain foreign currency regulations under Section 987. The affected regulations will be amended to apply to tax years beginning after 7 December 2023 (e.g., to 2024 for calendar-year taxpayers).

House Ways and Means Committee Republicans want Treasury information on BEPS 2.0 Pillar One impact

House Ways and Means Committee Republicans introduced a resolution dated 26 July 2022 that would require Treasury to produce documents showing the effects of the OECD BEPS 2.0 Pillar One rules. According to the resolution, the Treasury Secretary would be compelled to provide the House with "Pillar One tax revenue modeling data and reports" on the impact of the BEPS 2.0 Pillar One agreement on reallocation of taxing rights, as well as the overall economic effects of the Pillar One agreement.

The deferral was expected and is helpful because it gives taxpayers time to create and implement the complex systems and processes necessary to transition to the 2016 final regulations. Notice 2022-34 does not mention that the IRS is considering changes to these regulations to simplify the rules (although it has been mentioned in prior deferral notices).

Until the final regulations are effective, taxpayers must compute Section 987 gain or loss under a reasonable method and must also apply the deferral-event and outbound-loss-event rules of Reg. Section 1.987-12.

Practitioners generally view a reasonable method as including (1) the methodology provided in the1991 proposed regulations; (2) the "Earnings Only" methodology; or (3) early adoption of the 2016 final regulations. Such Section 987 gain or loss can affect taxable income or global intangible low taxed income (GILTI) under Section 951A, each of which in turn may affect many other current income tax provisions.

IRS announces delay in effective date of Section 871(m) regulations

The IRS in late August 2022 announced plans to delay the effective date for aspects of the Section 871(m) regulations and further extend transition relief. More specifically, the IRS in Notice 2022-37 indicated that it plans to delay the effective/applicability date for certain rules in final regulations under Section 871(m) and to extend for two more years the phase-in period provided in Notice 2020-2 for certain provisions of the regulations.

The US government in December 2019 issued final regulations (TD 9887) under Section 871(m) with guidance for entities that hold certain US equities and financial products referencing US-source dividends. Notice 2020-2 was issued concurrently with the 2019 final regulations. It announced that the IRS was extending the transition relief provided in Notice 2018-72 for two additional years and that it planned to amend the Section 871(m) regulations to reflect the delayed effective/applicability dates. These final Section 871(m) regulations are relevant for entities making payments to non-US entities on derivatives and other financial instruments referencing US equity securities.

The further extension of the phase-in period for certain provisions of the Section 871(m) regulations provides financial industry participants yet more time to implement the complex systems and processes necessary to comply with the rules of the Section 871(m) regulations.

Transfer pricing news

Tax Court increases Medtronic royalty rate under unspecified TP method

The US Tax Court on 18 August 2022 issued its second opinion in *Medtronic, Inc. and Consolidated Subsidiaries v. Commissioner* (Medtronic III). In this opinion, the Tax Court rejected the principal transfer pricing analysis of both the IRS and Medtronic Inc. (Medtronic US), instead applying an unspecified method proposed in the alternative by Medtronic to determine the royalty rate for license agreements between Medtronic US and its Puerto Rican subsidiary. Using this method, the Tax Court increased the wholesale royalty rate to 48.8% for devices and leads for years 2005 and 2006.

This decision comes after the Eighth Circuit Court of Appeals vacated the Tax Court's first opinion in *Medtronic, Inc. and Consolidated Subsidiaries v. Commissioner* (Medtronic I). The Eighth Circuit, in Medtronic II, had concluded that the Tax Court failed to provide sufficient factual findings to enable the appeals court to evaluate the Tax Court's determination of the best transfer pricing method. As a result, the Eighth Circuit remanded the case to the Tax Court to make those findings.

The Tax Court's opinion in Medtronic III provides guidance for future related-party transactions. Transfer pricing cases are inherently factual, and each case stands on its own facts. The Tax Court's opinion shows that the Tax Court may utilize an unspecified method if the court determines that it is the most reliable method. The Tax Court gave credence to the industry-specific value of the products manufactured and the management of the risk.

Additionally, the Tax Court's analysis closely followed the comparability framework set forth in the transfer pricing regulations. When using a CUT method, the case indicates that courts will closely consider all facts and circumstances within the comparables when reviewing related-party relationships. In the wake of Medtronic III, taxpayers should put continued emphasis on best method selection and expect that the IRS will likely evaluate alternative methodologies.

Increased IRS funding from Inflation Reduction Act may increase scrutiny of transfer pricing cases

The recently enacted *Inflation Reduction Act* (Act) allocates nearly $80 billion in new funding for the IRS. Of that $80 billion, more than $45 billion is for enforcement (including the determination and collection of "owed taxes"), more than $25 billion is for operations, nearly $5 billion is for systems modernization, and over $3 billion is for customer service, among other expenses.

The Congressional Budget Office estimates the enforcement-related funding will raise $204 billion in additional revenue, offsetting the cost of the Act's incentives for energy transition and renewable energy, as well as its extension of the expiration date for expanded premium tax credits under the *Affordable Care Act*.

The increased funding for IRS enforcement will likely shift the current audit landscape and significantly increase the IRS's scrutiny of transfer pricing cases. Accordingly, taxpayers should consider enhancing their transfer pricing documentation so they can support their intercompany tax positions.

Besides enhanced documentation, taxpayers should consider using tax dispute resolution tools, such as ICAP, Advance Pricing Agreements, and Mutual Agreement Procedures. With the IRS audit environment poised to change in the future, taxpayers need to prepare.

OECD developments

OECD releases 2022 update on peer review of preferential tax regimes and no or only nominal tax jurisdictions

The OECD on 27 July 2022 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 2022 by the Inclusive Framework on BEPS.

The updated results cover new decisions on 12 preferential tax regimes. According to the press release, the total number of tax regimes that have been reviewed, or are under review, is 319. The reviews were undertaken by the Forum on Harmful Tax Practices (FHTP). Two regimes of Armenia and one of Pakistan were classified as "potentially harmful" and will be subject to further evaluation by the FHTP. The remaining nine regimes on which new decisions were announced have been abolished, are being amended, are under review or are considered to be "not harmful." The FHTP will continue its reviews and will provide periodic updates.

IRS extends deadline for unfiled 2019 and 2020 returns, penalty relief for certain 2019 and 2020 returns

The IRS on 24 August issued Notice 2022-36, automatically extending until 30 September 2022, deadlines for most individual and business taxpayers that did not file tax returns for tax years 2019 and 2020. The notice also provides penalty relief to taxpayers for certain failure-to-file penalties for tax returns for 2019 and 2020. The notice applies to certain information return penalties for: (i) tax year 2019 returns filed on or before 1 August 2020; and (2) tax year 2020 returns filed on or before 1 August 2021.

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