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# Washington Dispatch

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## Legislation

### House Republicans pass debt ceiling, spending bill; impasse continues

The US House on 26 April passed the *Limit, Save, Grow Act of 2023* (HR 2811), a bill assembled by the Republican leadership that would suspend the statutory debt ceiling until 31 March 2024, or until \$1.5 trillion of debt over the current statutory limit is incurred (whichever happens first).

The bill would also cut trillions of dollars in spending across a broad swath of programs and repeal a number of tax breaks enacted in last year's *Inflation Reduction Act* (IRA), among other changes. The Congressional Budget Office concluded that the bill would result in \$4.8 trillion in deficit reduction from 2023-2033, while also reducing projected tax collections by \$191 billion during that period as a result of repealing IRS funding provided in the IRA. Four Republicans voted against the bill, which passed the House 217-215.

The Senate is not expected to take up the bill. President Biden said before the bill was passed that he would veto the legislation if it came to his desk, insisting at the time that he would not negotiate with congressional Republicans and will only sign a "clean" bill to raise the debt ceiling.

## IRS news

### IRS provides transition period for documentation requirements for FTC 'single country exception'

The IRS on 3 April announced in [Notice 2023-31](#) that it will provide a 180-day transition period for meeting the documentation requirements in Reg. Section 1.903-1(c)(2)(iv)(D) for the foreign tax credit "single-country exception" under Prop. Reg. Section 1.903-1(c)(2)(iii)(B) after the regulations are finalized.

Previously, in November 2022, the IRS published proposed regulations ([REG-112096-22](#)) that addressed the definition of a foreign income tax and provided a limited exception to the source-based "attribution requirement" for certain withholding taxes imposed on certain royalty payments.

The proposed regulations would provide certain relief from the cost recovery requirement and the source-based attribution requirement on royalty income for purposes of determining the creditability of foreign taxes under Sections 901 and 903.

The proposed regulations would modify the final foreign tax credit regulations published in January 2022 ([TD 9959](#)), as amended by technical corrections ([87 FR 45018](#) & [87 FR 45021](#)) published in July 2022.

### IRS updates crypto notice, virtual currency remains unavailable to generate FX gain or loss

The IRS on 24 April released [Notice 2023-24](#), updating earlier guidance ([Notice 2014-21](#)) to remove a sentence that described digital currency as "not having legal tender status in any jurisdiction." The amendment was made due to law changes in foreign jurisdictions that characterize Bitcoin as legal tender.

The change to Notice 2014-21 does not affect the answers to the FAQs in the 2014 guidance, including the conclusion that convertible virtual currency is not treated as currency that could generate foreign currency gain or loss for US federal tax purposes. Notice 2014-21 provides that convertible virtual currency is treated as property for US federal tax purposes and general tax principles that apply to property transactions also apply to transactions that use convertible virtual currency.

## No decision on new CAMT interim guidance

A US Treasury official at the end of April 2023 said no decision has been made on whether the government will issue interim guidance on the new corporate alternative minimum tax (CAMT). The official was quoted as saying that while the "overriding comment" from taxpayers is that more CAMT guidance is needed, it is still not clear if Treasury will wait for proposed regulations or issue further notices.

## US, Germany sign CAA on exchanging CbC reports

The US and Germany on 24 March 2023 signed a [competent authority arrangement](#) on the automatic exchange of country-by-country (CbC) reports. The [IRS CbC Reporting Jurisdiction Status Table](#) states that the arrangement's operative date is "To be determined."

## IRS addresses micro-captive transactions as listed transactions

The IRS issued proposed rules ([REG-109309-22](#)) in April 2023 that would obsolete Notice 2016-66 and identify transactions that are the same as, or substantially similar to, certain micro-captive transactions as listed transactions and other micro-captive transactions as transactions of interest. Material advisors and certain participants in these listed transactions and transactions of interest must file disclosures with the IRS or face penalties.

The IRS also released [Announcement 2023-11](#), which explains that the rules are being proposed in light of certain court decisions holding that the *Administrative Procedure Act* requires the IRS to identify listed transactions through notice-and-comment rulemaking, and that the IRS intends to issue further regulations identifying other listed transactions, to be finalized in 2023.

A public hearing is scheduled for 19 July 2023; comments on the regulations may be sent to the IRS through 10 June 2023.

## IRS releases general plan for spending \$80 million over the next 10 years

The IRS announced ([IR-2023-72](#)) the publication of its [Strategic Operating Plan](#) (Plan), with an outline of how it will spend the almost \$80 billion allocated by the *Inflation Reduction Act* (IRA) from now through FY 2031. The Plan, a 150-page high-level document, was requested by Treasury Secretary Yellen in August 2022.

The IRA provided funding in the IRS's four appropriation buckets, allocating \$47.4 billion to enforcement, \$3.2 billion to taxpayer service, \$25.3 billion to operations support, and \$4.8 billion to business systems modernization. The IRS cannot transfer money among those buckets without congressional approval.

Overall, the IRS said it will pursue five main objectives:

- ▶ Improve taxpayer services
- ▶ Quickly resolve taxpayer issues
- ▶ Focus expanded enforcement on complex tax filings and high-dollar noncompliance issues
- ▶ Deliver cutting-edge technology, data and analytics
- ▶ Hire and retain a highly-skilled, diverse work force

Within each of these objectives, the IRS identifies a total of 42 initiatives, indicators of success, milestones, and interdependencies. It also provides a high-level breakdown of expenditures and a roadmap sequencing the various initiatives.

For large corporations and partnerships, the IRS said it will increase audit rates and other compliance treatments by using data and analytics and pursuing noncompliance through a variety of mechanisms, including audits and non-audit contacts.

## Transfer pricing

### IRS interim guidance on APA submissions fundamentally changes early stages of process

The IRS's Acting Director of Treaty and Transfer Pricing Operations (TTPO) recently informed IRS employees of new internal procedures for APA pre-filing meeting requests and the review and acceptance of APA submissions. The guidance, released in a 25 April 2023 [Memorandum for Treaty and Transfer Pricing Operations Employees](#) (memo), implements a rigorous screening process whereby the Advance Pricing Mutual Agreement team (APMA) (along with other TTPO personnel) may shift taxpayers from the APA process to alternative workstreams.

The IRS's stated goal for the procedural change is "to improve the quality and timeliness of APMA's APA program by providing an early mechanism for identifying potential roadblocks to successfully concluding a proposed APA and opportunities for other paths to certainty."

While the memo represents interim guidance for the moment, it states that it will be incorporated into the Internal Revenue Manual within the next two years. The memo applies to pre-filing memoranda and APA requests filed on or after 25 April 2023.

The procedural changes set out in the memo fundamentally change the early stages of the APA process. APMA will now engage in a rigorous two-step review of APA requests – the first at the prefiling stage and the second after an APA submission is filed. At each step, APMA may decline a taxpayer’s APA request and recommend the taxpayer apply to the International Compliance Assurance Program (ICAP) or indicate that the issues are better suited to be handled in an audit – joint or domestic. Given this change, it is possible that the new procedures will reduce the number of APAs accepted into the APA program.

It appears that the IRS wants to set APAs up for success and believes that encouraging taxpayers to consider ICAP and joint audits is a way to achieve that goal. Some taxpayers with simpler transactions may find ICAP appealing; it does not have a user fee, may require less documentation, is faster than the average APA negotiation, may include agreement among a larger number of jurisdictions, and provides comfort or practical certainty that the governments involved will not re-examine the transactions. It does not, however, provide the legal certainty of an APA.

## Courts

### **US Tax Court rules IRS cannot assess penalties under Section 6038(b) for willfully failing to report foreign income**

The Tax Court held in [Farhy v. Commissioner](#) (April 2023) that the IRS is not authorized to assess penalties under Section 6038(b) against a taxpayer that willfully failed to report foreign income on [IRS Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations](#). As a result, the IRS cannot collect the penalties it assessed through a levy notice. The IRS may, however, collect the penalties through a civil action.

The Tax Court concluded that “Congress has explicitly authorized assessment with respect to myriad penalty provisions in the Code, but not for [IRC S]ection 6038(b) penalties.” The court went on to say “we are loath to disturb this well-established statutory framework by inferring the power to administratively assess and collect the [IRC S]ection 6038(b) penalties when Congress did not see fit to grant that power to the Secretary of the Treasury expressly as it did for other penalties in the Code.”

The decision of the Tax Court, if unchanged on appeal, would broadly undermine the IRS’s current practices for assessing and collecting penalties under Section 6038. The Tax Court suggests in its decision that the IRS pursue such penalties through civil action under 28 U.S.C. Section 2461(a).

Without a court decision imposing the penalties, the IRS’s administrative determination, standing alone, would be insufficient to impose any payment obligation on taxpayers for the penalty under Section 6038. Similar reasoning may apply to other penalties in the Code that are not specifically identified as assessable.

While the Tax Court’s decision remains subject to appeal and only addresses Section 6038, taxpayers who have paid penalties under Section 6038 (or similar penalty provisions not specifically identified as assessable penalties) based only upon the IRS’s assertion of such penalties may consider whether a timely refund claim or other action is warranted in light of the Tax Court’s decision.

### **OECD to release BEPS Pillar Two QDMTT safe harbor by summer, official says**

An OECD official in late April 2023 was quoted as saying the organization expects to release a BEPS Pillar Two qualified domestic minimum top-up tax (QDMTT) safe harbor by summer, and is also working on other safe harbors and simplifications. The official specified the OECD is working on other QDMTT guidance, substance-based income exclusion and deferred tax liability recapture rules. Finalization of the Pillar Two GLoBE information return reportedly is still on track for release in mid-2023.

## OECD developments

### **OECD releases fifth annual peer review report on BEPS Action 6 on prevention of treaty abuse**

The OECD on 21 March 2023 released the fifth annual peer review report (the [Report](#)) on the implementation of the BEPS Action 6 minimum standard relating to the prevention of treaty abuse. The Report reflects detailed information on the implementation of the minimum standard by the 141 jurisdictions that were members of the Inclusive Framework on 31 May 2022.

The Report shows that generally most jurisdictions that are members of the Inclusive Framework are respecting their commitment to implement the minimum standard. The 2022 peer review also indicates that the BEPS Multilateral Instrument (MLI), which has been the main tool used to implement the minimum standard, has continued to have a significant effect on the bilateral tax treaty network.

As of 31 May 2022, more than 975 bilateral agreements between members of the Inclusive Framework complied with the minimum standard. An additional 76 agreements not subject to review (i.e., agreements between Inclusive Framework members and nonmembers) also complied with the minimum standard, bringing the total number of compliant agreements concluded by members of the Inclusive Framework to more than 1,050 agreements, which represents a significant increase from 2021.

The Report also shows that more than 850 agreements concluded between members of the Inclusive Framework are covered by the MLI. More than 870 additional agreements will become compliant under the BEPS MLI once all relevant signatories have ratified it.

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