Year-in-Review

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This special issue of the Washington Dispatch is a compilation of significant US international tax developments and guidance issued during the period of 1 January through 31 December 2023, addressing inbound and outbound taxation. The material is divided by subject area with most recent events listed first.

Table of contents

Legislation 6

House Ways and Means Committee clears US-Taiwan tax bill 6
House of Representatives elects new Speaker 6
US-Taiwan legislation moves forward 6
Congress pivots to crypto assets, requests comments on tax uncertainties 6
House Ways and Means Republicans release tax package 7
Congress passes debt ceiling bill, averts possible default 7
Senate Finance Committee holds Rx, international tax hearing 8
House Republicans pass debt ceiling, spending bill; impasse continues 8
Senate Finance Committee FY'24 Budget hearing focuses on BEPS agreement 8
President Biden releases FY'24 Budget with major international policy proposals 9
President Biden delivers State of the Union address, proposes fourfold increase in stock buyback excise tax, 'billionaire surtax' 10
Kevin McCarthy elected new House Speaker, Rep. Smith chairs Ways and Means Committee 10

OECD BEPS 2.0 – US considerations 10

Treasury provides guidance on creditability of BEPS Pillar Two taxes, relief for pre-GloBE DCLs and extends temporary relief from FTC regs 10
House Republicans want countries to delay BEPS Pillar Two, adopt GILTI-like regime 11
Congressional Republicans criticize BEPS 2.0 project 12
Congressional JCT provides revenue estimates for BEPS 2.0 Pillar Two 12
House Ways & Means Republicans introduce tax increase on foreign companies to influence global tax deal 13
House Ways and Means Committee Chairman calls BEPS Undertaxed Profits Rule 'fundamentally flawed' 13

Foreign tax credits 13

Treasury temporarily delays controversial foreign tax credit regulations 13
IRS provides transition period for documentation requirements for FTC 'single country exception' 14

Transition Tax – Section 965 14

US Supreme Court hears oral arguments in *Moore* transition tax case 14

Corporate 15

Interim guidance released on treatment of basis adjustments under Section 961(c) on inbound liquidation or asset reorganization 15

IRS to broaden scope of corporate PLRs 15

IRS proposed regulations would amend Section 367(b) regulations applying to certain cross-border triangular reorgs, inbound nonrecognition transactions 15

IRS rules converting disregarded entity to domestic corporation does not modify debt 16

IRS proposes updating regulations on consolidated returns, discarding unnecessary guidance 16

IRS makes permanent fast-track program to resolve certain corporate PLR requests 17

IRS plans further IP guidance 17

IRS proposed regulations would turn off Section 367(d) following certain IP repatriations 17

Corporate Alternative Minimum Tax (CAMT) 18

IRS interim CAMT guidance provides relief from possible double-counting of CFC earnings in AFSI, but possible compliance burdens 18

IRS publishes additional interim guidance clarifying CAMT 19

IRS waives addition to tax for a corporation's failure to make estimated tax payments of its CAMT 20

Foreign Investment in Real Property Tax Act (FIRPTA) 20

IRS GLAM concludes FIRPTA regularly-traded-stock-exception test under Section 897(c)(3) applies at partnership level 20

IRS proposed regulations would make major changes to domestically controlled QIE rules under Section 897, and certain controlled commercial entity rules under Section 892 21

Final regulations issued for qualified foreign pension funds contain some favorable clarifications 21

Tax treaties 22

IRS updates list of treaties 22

US Treasury announces entry into force of the US-Chile tax treaty 22

US-Chile tax treaty's US reservations reflect current policy 22

Russia suspends US-Russia, other tax treaties 22

US negotiating tax agreements with Israel, Switzerland and Norway 23

US-Hungary treaty termination effective 8 January 2023 23

Capital markets 23

IRS issues proposed regulations on QBUs, including simplified elections for determining Section 987 gain or loss but restrictions on loss recognition 23

Turkish Lira's hyperinflationary status has federal tax implications for US multinationals 24

Cryptocurrency and NFTs 24

IRS issues proposed regs on broker reporting requirements for digital asset sales and exchanges 24

Cryptocurrency stakers must include rewards in gross income upon gaining control 25

IRS updates crypto notice, virtual currency remains unavailable to generate FX gain or loss 25

IRS in Chief Counsel Advice 202316008 finds change in blockchain protocol not taxable event 25

IRS announces plans to issue guidance on certain NFTs as collectibles 25

IRS addresses deductions involving cryptocurrency in two Chief Counsel Advice memos 26

Transfer pricing 26

IRS appeals Tax Court's latest decision in *Medtronic* 26

US, Israel sign CAA on exchange of CbC reports 26

Cyprus issues clarification note on future CbC exchange agreement with US 27

Treasury official states US preference on transfer pricing rules 27

IRS announces intent to issue proposed regulations for Section 174, would affect cost sharing arrangements 27

IRS interim guidance on APA submissions fundamentally changes early stages of process 28

IRS considering Section 482 regulation for parent's implicit support in pricing intercompany loans 28

US Tax Court approves IRS/Eaton Corporation agreement resolving APA cancellation case 28

IRS examiners must consult IRS Counsel before applying economic substance doctrine in transfer pricing audits 29

Withholding 29

Tax Court rules non-US partnership was securities dealer engaged in US trade or business, liable for partnership withholding tax 29

Tax administration 30

IRS sending compliance alerts to US subs of foreign-owned corporations 30

IRS 2024 CAP program accepting new applications 30

Tax Court rules IRS cannot assess penalties under Section 6038(b) for willfully failing to report foreign income 30

Miscellaneous 31

FASB modifies income tax disclosure rules 31

US officials offer international regulatory update 31

US court denies DRD after applying economic substance doctrine 32

IRS informing taxpayers of Schedule UTP non-compliance 32

IRS announces major new compliance initiative targeting large partnerships 32

OMB's Office of Information and Regulatory Affairs will no longer review tax regulations 33

IRS releases general plan for spending $80 billion over the next 10 years 33

IRS addresses micro-captive transactions as listed transactions 33

OECD 34

BEPS 2.0 34

OECD/G20 IF releases BEPS Pillar Two GloBE rules guidance, new Pillar One MLC timeline 34

OECD, country officials discuss BEPS 2.0 Pillars One and Two and other OECD tax work 35

OECD/G20 Inclusive Framework releases technical documents on BEPS Pillars One and Two 35

OECD releases Outcome Statement on progress on Pillars One and Two of BEPS 2.0 project 36

BEPS 2.0 Pillar One 36

OECD official says BEPS Pillar One MLC preferable to the alternative 36

OECD releases text of Amount A Pillar One MLC, Treasury announces consultation 37

BEPS Pillar One to follow revised implementation plan 37

BEPS 2.0 Pillar Two 38

BEPS IF considering Pillar Two guidance on deferred tax assets 38

OECD/G20 Inclusive Framework launches Multilateral Convention to implement Pillar Two Subject to Tax Rule 38

Global minimum tax filing simplification possible, OECD official says 38

OECD holds public consultation meeting on compliance and tax certainty aspects of BEPS Pillar Two global minimum tax 38

OECD releases additional administrative guidance on BEPS 2.0 Pillar Two 39

OECD's Pillar Two administrative guidance raises implications for US multinationals 39

Tax treaties 40

OECD releases fifth annual peer review report on BEPS Action 6 on prevention of treaty abuse 40

Transfer pricing 40

OECD releases outcomes of sixth peer review on BEPS Action 13 on CbCR 40

OECD releases revised methodology for BEPS Action 14 peer reviews, updates on reporting of MAP and APA statistics 40

Preferential tax regimes 40

OECD releases 2023 update on peer review of preferential tax regimes 40

Miscellaneous 41

OECD announces 48 jurisdictions to implement CARF by 2027 41

OECD FTA agrees on action to support continued digital transformation, delivering Pillar Two and capacity building 41

OECD Secretary-General Tax Report provides international tax update 41

OECD releases 2023 report on tax transparency in Latin America 42

United Nations 42

UN releases final report on international tax cooperation 42

Legislation

House Ways and Means Committee clears US-Taiwan tax bill

The US House Ways and Means Committee on 30 November 2023 unanimously approved the bipartisan *United States-Taiwan Expedited Double-Tax Relief Act* (H.R. 5988), under which income from US sources earned or received by qualified residents of Taiwan would be entitled to certain benefits. H.R. 5988, which would add Section 894A to the Code, was amended to add a new provision that would authorize the President to negotiate and enter into one or more non-self-executing tax agreements to provide for bilateral tax relief with Taiwan after a determination is made that Taiwan has provided benefits to US persons that are reciprocal to the benefits provided under Section 894A. The new provision is similar to the Senate Foreign Relations Committee proposal released earlier in the year authorizing the negotiation of a tax agreement with Taiwan.

Subject to reciprocity requirements, the Ways and Means bill would reduce the general statutory 30% withholding tax on certain US-source income received by qualified residents of Taiwan.

Both Chairman Jason Smith (R-MO) and Ranking Member Richard Neal (D-MA) highlighted the bill's reciprocity requirements, under which the bill's provisions apply only if reciprocal provisions apply to US persons with respect to income sourced in Taiwan.

The Taiwan tax issue has bipartisan support and is rooted – at least in part – by interest in boosting semiconductor chip production. The Taiwan bill is considered a candidate to be attached to a broader tax measure.

House of Representatives elects new Speaker

The US House of Representatives on 25 October 2023 elected Rep. Mike Johnson (R-LA) to be the next Speaker, with members voting 220 to 209 along strictly party-lines. The vote came over three weeks after the ouster of House Speaker Kevin McCarthy (R-CA) from the leadership post on 3 October.

The new Speaker quickly set an ambitious schedule for regular-order consideration of appropriations bills and said a continuing resolution (CR) – after the expiration of the existing CR on 17 November – should end on 15 January or 15 April so the Senate can't "jam" the House with a year-end omnibus spending bill. Speaker Johnson also said he would create a bipartisan debt commission.

US-Taiwan legislation moves forward

The *United States-Taiwan Expedited Double Tax Relief Act* that was passed unanimously by the Senate Finance Committee in September was formally introduced in the Senate (S. 3084) on 19 October 2023 by Chairman Ron Wyden (D-OR) and Ranking Member Mike Crapo (R-ID) and in the House (H.R. 5988) by Ways and Means Committee Chairman Jason Smith (R-MO) and Ranking Member Richard Neal (D-MA).

The updated text reflects the Finance Committee's amendment to prevent double taxation on payments to entertainers and athletes in certain circumstances, as well as some other changes.

Separately, the Senate Foreign Relations Committee on 13 July approved the *Taiwan Tax Agreement Act* (S. 1457), a bill to authorize the President to negotiate and enter into a tax agreement with Taiwan to relieve double taxation.

Michael Plowgian, Deputy Assistant Treasury Secretary for International Tax Affairs, confirmed that a tax information exchange agreement with Taiwan is currently being negotiated.

Congress pivots to crypto assets, requests comments on tax uncertainties

Senators Cynthia Lummis (R-WY) and Kirsten Gillibrand (D-NY) on 12 July 2023 reintroduced the *Lummis-Gillibrand Responsible Financial Innovation Act* to create a comprehensive regulatory framework for crypto assets. The legislation, which includes a Tax Title, significantly expands on the original bill introduced last year, including new consumer protections and safeguards against fraud and bad actors.

JCT releases 'Bluebook" explanation

The congressional Joint Committee on Taxation (JCT) on 21 December 2023 released the "General Explanation of Tax Legislation Enacted in the 117th Congress," also known as the Bluebook.

The day before, Senate Finance Committee Chairman Ron Wyden (D-OR) and Ranking Member Mike Crapo (R-ID) asked for comments on "uncertainties surrounding the tax treatment of digital assets with an open letter seeking input from experts, stakeholders and interested parties" across several areas. The Committee release said answers to questions would be collected on a rolling basis until 8 September.

A Congressional Joint Committee on Taxation Report, dated June 2023 but released on 11 July, reviewed a number of issues related to digital assets.

House Ways and Means Republicans release tax package

The US House Ways and Means Committee on 13 June approved three separate tax packages: the T*ax Cuts for Working Families Act*, *Small Business Jobs Act, and Build It in America Act*, following a 10-hour markup. The three bills, combined into the *American Families and Jobs Act*, fulfill Chairman Jason Smith's (R-MO) commitment to develop a tax-based economic package.

The bills are not expected to be enacted in their current form, given that the *Tax Creation and Jobs Act* "pre-cliffs" relating to expensing of R&D costs, interest deduction limitations under Section 163(j), and 100% expensing of manufacturing equipment remain stalled as Democrats insist on expanding the Child Tax Credit. Democrats also strongly oppose rolling back clean energy provisions from the *Inflation Reduction Act* that Republicans hope to use as revenue offsets for the released tax package.

There was some speculation at the time that the proposed tax legislation could represent the House GOP's starting position for talks later this year aimed at putting together a year-end tax extenders package.

Congress passes debt ceiling bill, averts possible default

The House (314-117) and Senate (63-36) in late May 2023 passed the *Fiscal Responsibility Act of 2023* (H.R. 3746), a debt ceiling bill agreed to by President Biden and House Speaker Kevin McCarthy (R-CA). President Biden signed the legislation into law on 1 June.

The deal came just days before the 5 June deadline that Treasury Secretary Janet Yellen cited as the potential date the US could default on its debt. The legislation suspends the statutory debt ceiling through 1 January 2025, along with applying curbs on government spending and clawbacks of IRS and COVID-19-related funding.

The Act rescinds $1.4 billion of the *Inflation Reduction Act's* $80 billion in increased IRS funding.

According to the Congressional Budget Office, the bill would reduce deficits by $1.5 trillion over the 2023-2033 period relative to May 2023 baseline projections under caps to discretionary funding provisions in the legislation.

Canada confirms plans for DST, may lead to US response

The Canadian government presented its 2023 Fall Economic Statement on 21 November 2023, confirming its intention to proceed with plans to enact a 3% Digital Services Tax (DST) in 2024, setting the stage for a possible showdown with the US government. The proposed Canadian DST would be effective 1 January 2024 and apply retroactively to 1 January 2022. Bipartisan members of Congress have warned that the United States "would examine all options, including under our trade agreements and domestic statutes," if Canada introduces the DST.

Senate Finance Committee Chairman Ron Wyden (D-OR) and Ranking Member Mike Crapo (R-ID) in a 10 October 2023 letter called on the U.S. Trade Representative (USTR) to make clear that the United States will forcefully defend American employers against Canada's proposed 3% DST. The senators urged the USTR to tell the Canadian government it will "immediately respond using available trade tools upon Canada's enactment of any DST."

Senate Finance Committee holds Rx, international tax hearing

The Senate Finance Committee (SFC) on 11 May 2023 held a hearing on "Cross-border Rx: Pharmaceutical Manufacturers and U.S. International Tax Policy." Democratic members and some witnesses criticized perceived profit shifting by the pharmaceutical industry even after enactment of the 2017 *Tax Cuts and Jobs Act's* guardrails, while Republican members expressed concern about the effect of the OECD-led Pillar Two global minimum tax on US multinational corporations, particularly the undertaxed profits rule (UTPR) and treatment of US tax credits including the R&D tax credit.

In effect, it was the tale of two hearings. The SFC Democratic majority released a report ahead of the hearing finding that large pharmaceutical companies report a collective 75% of taxable income in foreign subsidiaries, including for some drugs that are household names in the US. Republicans, meanwhile, used the hearing to focus on Pillar Two and the UTPR.

House Republicans pass debt ceiling, spending bill; impasse continues

The US House on 26 April 2023 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 was 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.

Senate Finance Committee FY'24 Budget hearing focuses on BEPS agreement

Treasury Secretary Janet Yellen on 16 March 2023 testified before the Senate Finance Committee during a hearing ostensibly on the President's Fiscal Year 2024 Budget but that focused on the current banking crisis as well as the OECD-led global tax agreement. Committee Republicans expressed concern about various aspects of the BEPS 2.0 negotiations, with Ranking Member Mike Crapo (R-ID) saying he opposed the OECD agreement.

Members of both parties also expressed concern about Secretary Yellen's recent comments that future limited free trade agreements focused on battery minerals with the European Union (EU) and other allies would not need approval from Congress.

Senate Finance Committee holds hearing on IRS Chief Counsel pick

Margorie Rollinson, President Biden's pick to become IRS Chief Counsel and Treasury Assistant General Counsel, testified at her Senate Finance Committee confirmation hearing on 28 September 2023. Rollinson spent most of her career at EY, retiring as EY Deputy Director of National Tax, and has held several senior positions at the IRS including Associate Chief Counsel (International).

International tax was one area of focus for committee Republicans during the confirmation hearing. Ranking Member Mike Crapo (R-ID) said the Administration "invited foreign governments to pursue new discriminatory taxes against our companies in the form of the Undertaxed Profits Rule (UTPR), a surtax which also likely violates our existing bilateral tax treaties." According to Senator Crapo, a collateral consequence was that "Treasury must now exhaust precious resources issuing regulations to attempt to mitigate the double taxation it created by unilaterally committing to a global tax deal that undermines U.S. interests."

President Biden releases FY'24 Budget with major international policy proposals

President Biden on 9 March 2023 released the Administration's FY 2024 Budget and accompanying Treasury Greenbook, calling for $3 trillion in deficit reduction including through tax increases on corporations and wealthy individuals.

The Budget is a blueprint for the President's preferred policies irrespective of their chances of being enacted, and generally is intended to strike a contrast with spending cuts called for by House Republicans. It continues to call for tax provisions that fell out of the Build Back Better negotiations that eventually led to the *Inflation Reduction Act* (IRA).

The proposals include a previously outlined quadrupling of the IRA's stock buyback excise tax in Section 4501 from 1% to 4% and a "billionaire's tax" that would impose a 25% minimum tax – higher than the previously proposed 20% – on total income, inclusive of unrealized capital gains, for taxpayers with wealth of greater than $100 million. Many of the Budget's tax proposals are taken from the President's first Budget (FY 2022), the House-passed *Build Back Better Act* that did not pass the Senate and last year's Budget (FY 2023).

The President's FY 2024 Budget proposes to increase the tax rate for C corporations from 21% to 28%.

Other corporate tax proposals would amend the Code in several ways to ensure that a transfer of property by a corporation to its shareholder(s) cannot be made through transactions that avoid dividend treatment for the corporation's shareholders. The Budget would also limit tax avoidance through inappropriate leveraging of parties to divisive reorganizations, limit losses recognized in liquidation transactions, and prevent basis shifting by related parties through partnerships, among other proposals.

International tax proposals

The FY2024 Budget includes few new international tax proposals, largely reprising proposals from prior budgets. Over $1.1 trillion, or 29% of the increases in total net tax, would come from reforms to the international tax rules, The international tax proposals would:

- Limit the Section 250 deduction to 25%, which together with the proposed corporate rate increase to 28% would increase the effective rate on global intangible low-taxed income (GILTI) to 21%
- Modify the GILTI regime to align with the global minimum tax rules under OECD BEPS Pillar Two, including by applying the GILTI rules on a country-by-country basis
- Replace the base erosion and anti-abuse tax (BEAT) with an "undertaxed profits rule" (UTPR) that is consistent with the UTPR in the Pillar Two rules
- Repeal the deduction for foreign-derived intangible income (FDII)
- Create a new general business credit equal to 10% of eligible expenses incurred when onshoring a trade or business to the United States
- Disallow deductions for expenses incurred when moving a US trade or business offshore
- Eliminate the exceptions in computing a controlled foreign corporation's earnings and profits (E&P) for purposes of Section 952(c)
- Create a second type of US shareholder to include in income amounts determined with respect to non-taxed dividends
- Limit foreign tax credits on sales of hybrid entities
- Restrict deductions of excessive interest expense
- Modify the treatment of certain derivative transactions for foreign investors
- Permit taxpayers to retroactively elect, in certain circumstances, to treat a passive foreign investment company as a qualified electing fund without IRS consent
- Require Section 6038 reporting for each foreign "taxable unit"

The proposals have various effective dates.

The above tax proposals were designed to raise tax revenues to fund the Biden Administration's priorities. If enacted, they would significantly increase taxes on US multinational companies.

Taxpayers should keep track of these proposals. The fact that these proposals appeared in past legislation and budgets indicates that they could be used again as revenue offsets in future legislation.

President Biden delivers State of the Union address, proposes fourfold increase in stock buyback excise tax, 'billionaire surtax'

President Joe Biden gave his second State of the Union address to Congress on 7 February 2023, striking a mostly optimistic tone, pointing to the country's recovery from the COVID-19 pandemic and the creation of 12 million new jobs, among other developments. The President proposed reducing the budget deficit by $2 trillion with help from revenue raisers, including the 15% corporate alternative minimum tax enacted in the 2022 *Inflation Reduction Act*, quadrupling the current one percent tax on corporate stock buybacks and enacting a "billionaire surtax."

The President also proposed closing unspecified tax loopholes and "cracking down on wealthy tax cheats." According to some commentators, increasing the stock buyback excise tax and passage of a billionaire surtax had little chance of passing Congress this year.

Later in the month, Senate Finance Committee member Sherrod Brown (D-OH) and Chairman Ron Wyden (D-OR) introduced the *Stock Buyback Accountability Act of 2023*, which would increase the recently enacted one percent stock buyback excise tax to four percent.

Also in February, and for the fourth consecutive Congress, House Ways and Means Committee Member Lloyd Doggett (D-TX) and Senate Finance Committee Member Sheldon Whitehouse (D-RI) introduced the *No Tax Breaks for Outsourcing Act*. Among other things, the bill would eliminate the global intangible low-taxed income (GILTI) tax and foreign-derived intangible income (FDII) deductions and apply GILTI on a per-country basis, repeal the 10% exemption for tangible investments, and treat corporations managed and controlled in the US as domestic corporations.

Kevin McCarthy elected new House Speaker, Rep. Smith chairs Ways and Means Committee

Representative Kevin McCarthy (R-CA) became the new Speaker of the House of Representatives on 7 January 2023, reaching the necessary majority vote on the 15th ballot. Days later, the House GOP Steering Committee elected Representative Jason Smith (R-MO) to be the new chairman of the Ways and Means Committee.

In a statement, Representative Smith listed out his priorities, which included examining whether to "continue showering tax benefits on corporations that have shed their American identity" and using trade and tax policy to "re-shore and strengthen our supply chains, where products and services vital to our national security are made here at home using American labor," among others.

The press also reported that President Biden requested that Treasury Secretary Janet Yellen stay on in her post and that she accepted. The Treasury Secretary was expected to continue implementing provisions of the *Inflation Reduction Act* and to move forward with the BEPS 2.0 agenda.

OECD BEPS 2.0 – US considerations

Treasury provides guidance on creditability of BEPS Pillar Two taxes, relief for pre-GloBE DCLs and extends temporary relief from FTC regs

Treasury and the IRS issued Notice 2023-80 on 11 December 2023, outlining guidance on the interaction of the foreign tax credit (FTC) rules and dual consolidated loss (DCL) rules with top-up taxes imposed via the Pillar Two Global Anti-Base Erosion Model Rules' (GloBE Rules) Income Inclusion Rule (IIR) or a Qualified Domestic Minimum Top-Up Tax (QDMTT).

The government also announced its intent to issue proposed regulations that will align with this new guidance.

The Notice generally does not provide guidance on the FTC implications of the UTPR; however, Treasury and the IRS are analyzing these issues and plan to release additional guidance.

The Notice also extends, through tax years "ending before the date that a notice or other guidance withdrawing or modifying the temporary relief is issued (or any later date specified in such notice or other guidance)," the temporary relief from the application of regulations under Sections 901 and 903, which identify foreign taxes for which taxpayers may claim a credit (FTC Creditability Regulations) described in Notice 2023-55.

Pillar 2 taxes. Under Notice 2023-80, the creditability of a Pillar Two tax generally depends on whether it is a "final top-up tax," and if so, how it is computed. The Notice treats a foreign income tax as a final top-up tax if the foreign tax law "takes into account":

a. The amount of tax imposed on the direct or indirect owners of the entity subject to the tested tax by other countries (including the United States) with respect to the income subject to the tested tax, or

b. In the case of an entity subject to the tested tax on income attributable to its branch in the foreign country imposing the tested tax, the amount of tax imposed on the entity by its country of residence with respect to such income."

The Notice defines through examples a "final top-up tax" to include an IIR because an IIR is computed by taking into account the pushdown of taxes imposed on direct or indirect owners that are located in other countries. The rule on final top-up tax only applies to taxes that meet the definition of a "foreign income tax" (as defined under Reg. Section 1.901-2) and the examples assume that an IIR and QDMTT meet that definition.

A final top-up tax is not creditable (including for corporate alternative minimum tax purposes) if, under the foreign tax law, any amount of the taxpayer's US federal income tax liability (US tax liability) would be considered in computing the final top-up tax, regardless of whether the taxpayer has a US tax liability that is, in fact, included in the computation of the final top-up tax.

Final top-up taxes paid by controlled foreign corporations (CFCs) and partnerships are treated as creditable foreign income taxes at the level of the CFC or partnership, with any FTC disallowance applied at the level of the US shareholder or partner. According to the Notice, this treatment is intended to allow for the appropriate result when a final top-up tax should be creditable to one US shareholder or partner but not to another.

DCL rules. The Notice also indicates that Treasury and the IRS are studying the extent to which the DCL rules should apply to the GloBE Rules, including whether the GloBE Rules' jurisdictional blending should be treated as "foreign use" of a DCL.

Although the Notice states that more comprehensive guidance is pending, it provides that the Pillar 2 rules do not cause a foreign use to occur with respect to "legacy DCLs," meaning effectively pre-GloBE DCLs, solely because all or a portion of the deductions or losses that comprise a legacy DCL are taken into account in determining Net GloBE Income for a jurisdiction.

Applicability dates. Regarding application of the GloBE Rules to FTCs, the Notice anticipates that forthcoming proposed regulations will apply to tax years ending after 11 December 2023. Taxpayers may rely on the guidance in the Notice for tax years ending after 11 December 2023, and on or before the proposed regulations are published, as long as they apply the guidance consistently to all applicable tax years.

Regarding the application of the GloBE Rules to DCLs, taxpayers may rely on the guidance in the Notice until proposed regulations are published.

House Republicans want countries to delay BEPS Pillar Two, adopt GILTI-like regime

US House Republican tax lawmakers reportedly want countries to delay their implementation of BEPS Pillar Two, while also urging nations to adopt rules similar to the US global intangible low-taxed income (GILTI) regime. According to a press report released in mid-September 2023, the focus moved from the OECD to getting countries on board to adopt something akin to GILTI.

US House Ways and Means Committee Chairman Jason Smith (R-MO) along with committee members recently met with OECD Secretary-General Mathias Cormann in Paris, explaining the serious concerns with respect to the BEPS 2.0 project in the US Congress.

Chairman Smith told European officials that the US already has a global minimum tax — the GILTI regime — and does "not object to others implementing their own GILTI-type taxes." However, the Chairman warned that the US "will not suddenly repeal our proven system in favor of an untested regime with substantial complexity and uncertainty."

The Ways and Means delegation also told OECD officials of their strong objection to "discriminatory digital services taxes that countries have targeted at U.S. companies."

The Chairman singled out the Pillar Two Undertaxed Profits Rule (UTPR) as particularly problematic, saying: "If countries move forward with the UTPR surtax, we will continue to aggressively pursue tax and trade countermeasures." Last May, Chairman Smith, along with all committee Republicans, introduced the *Defending American Jobs and Investment Act*, which, if enacted, would impose reciprocal tax measures on multinational companies from countries that "try to use the UTPR to tax U.S. workers and productivity for their own gain."

According to a Ways and Means committee press release, there is also a concern that the global tax system is "headed for more, not fewer, disputes among countries."

Congressional Republicans criticize BEPS 2.0 project

Senate Finance Committee Ranking Member Mike Crapo (R-ID) and House Ways and Means Committee Chairman Jason Smith (R-MO) were not satisfied with the OECD's 17 July 2023 Administrative Guidance on BEPS 2.0 Pillar Two.

Senator Crapo and Chairman Smith said in a joint statement: "Once again, the Biden Administration neglected to consult Congress before cheerleading the OECD's latest global tax code rewrite. Today's [17 July] 'administrative guidance' acknowledges what Republicans have warned for more than two years: the UTPR [Under Taxed Profits Rule] surtax is unworkable and unlawful. … Moreover, the OECD's nonsensical treatment of investment incentives remains, which will send U.S. R&D jobs and tax revenues overseas."

The House Ways & Means Tax Subcommittee also held a hearing on 19 July that centered on the BEPS 2.0 project. Republicans challenged the Treasury witness, Michael Plowgian, Deputy Assistant Secretary for International Tax Affairs at the Department of Treasury, specifically questioning the constitutionality of allowing other nations a potential share of US taxes through the UTPR. They also criticized a global legal system under which they claimed the US research and development (R&D) credit is not treated the same way as refundable R&D credits provided by other countries.

Democrats on the committee in most cases sought to defend the BEPS project and the Biden Administration.

Plowgian testified that Treasury in the future would work with Congress, saying: "We hope to have a complete Pillar One package soon and intend to continue to seek input. Similarly, with respect to Pillar Two, we stand ready to work with Congress to enact the reforms proposed in the President's Budget to implement Pillar Two, which would increase U.S. revenue and strengthen our tax system. We will also continue to work with Congress to prioritize issues for interpretive guidance."

Congressional JCT provides revenue estimates for BEPS 2.0 Pillar Two

The staff of the Joint Committee on Taxation in late June 2023 prepared an analysis of the potential revenue impact to the US Treasury of implementation of BEPS Pillar Two based on various US and global scenarios. The report included projections showing a range of revenue implications, from a revenue loss over 10 years of as much as $174.5 billion to a revenue gain of as much as $224.2 billion.

The analysis was requested by House Ways and Means Committee Chairman Jason Smith (R-MO) and Senate Finance Committee ranking member Mike Crapo (R-ID).

The analysis begins with the assumption that all countries that have announced they will legislate Pillar Two this year do so. The analysis then includes five different forecasting scenarios, including whether the rest of the world enacts Pillar Two and the US does not, and whether the rest of the world enacts Pillar Two and the US does as well.

The JCT analysis notes that, "the range of revenue effects is significant and highlights the uncertain effect Pillar Two implementation may have on Federal tax receipts. In the lower bound, with US MNEs assumed to shift their low-tax profits to QDMTT [Qualified Domestic Minimum Top Up Tax] jurisdictions, any residual US tax on those profits is eliminated by the corresponding foreign tax credits. In the upper bound, with US MNEs assumed to shift their low-tax profits to the United States, there is significant increase in Federal tax revenues. The range of potential effects is meant to highlight the level of uncertainty here and is not meant to represent a likely outcome."

Senator Crapo initially released the report and issued a press release available here.

House Ways & Means Republicans introduce tax increase on foreign companies to influence global tax deal

US House Ways and Means Committee Chairman Jason Smith (R-MO), joined by every Republican on the Committee, on 25 May 2023 introduced legislation aimed at discouraging countries from adopting a key component of Pillar Two, the Undertaxed Profits Rule (UTPR).

The *Defending American Jobs and Investment Act* focuses on the potential impact on US multinational corporations that have an effective tax rate of less than 15%, within the meaning of Pillar Two, on their US profits because they've availed themselves of US tax incentives. The legislation would increase taxes on the US businesses of companies headquartered in countries that enact the UTPR, but it would also apply in the context of other taxes imposed on US businesses if those taxes meet a set of criteria deeming them to be either extraterritorial or discriminatory in nature.

The proposed legislation would add new Section 899 to cause rates specified in particular Code sections (e.g., Section 871(a)) to accelerate by 5% until the additional rate reaches 20% (an annual increase) when a foreign country enacts one or more extraterritorial taxes or discriminatory taxes. The text of the bill is available here.

Under the new section, the Secretary will be required to submit a report 90 days after enactment and at least every 180 days thereafter. The report will identify the country, describe the tax, and the rate of tax being imposed by the foreign jurisdiction. Then, the Secretary "shall commence enhanced bilateral engagement" with each listed country to express concern, urge repeal, and advise of remedial actions.

Chairman Smith said: "As the exclusive trade and tax-writing committee in the House of Representatives, the Ways and Means Committee has a variety of tools that can be deployed to stop bad actors that try to harm American workers and businesses. We remain prepared to invoke additional tax and trade countermeasures, should these attempts to undermine our tax sovereignty continue."

It is unlikely that this legislation will be enacted in this Congress as it would require bipartisan support and the support of the Biden Administration. Committee Republicans instead hoped the introduction of the bill will encourage the OECD and the Inclusive Framework participants in Pillar Two to reconsider introduction of UTPRs in their own domestic legislation.

A number of countries are in the process of enacting both the Income Inclusion Rule and the Qualified Domestic Minimum Top-up Tax for effect in 2024 but have put off enactment of the UTPR as many countries have agreed it should not take effect until 2025 at the earliest.

House Ways and Means Committee Chairman calls BEPS Undertaxed Profits Rule 'fundamentally flawed'

Addressing the OECD-led BEPS 2.0 global tax agreement, House Ways and Means Committee Chairman Jason Smith (R-MO) sent a letter to OECD Secretary-General Mathias Cormann on 10 February 2023, in which he defended the US global intangible low-taxed income (GILTI) regime and said other countries are considering a minimum tax only if they can impose the "fundamentally flawed" Undertaxed Profits Rule (UTPR) on US companies.

The chairman warned that the UTPR would target US tax incentives like the research and development credit "as well as the operations of American companies in third-party jurisdictions." Chairman Smith said House Republicans "will aggressively pursue tax and trade countermeasures to protect American jobs, sovereignty, and tax revenues."

Foreign tax credits

Treasury temporarily delays controversial foreign tax credit regulations

The US government on 21 July 2023 released Notice 2023-95, temporarily relieving taxpayers from the application of regulations under Sections 901 and 903 identifying foreign taxes for which taxpayers may claim a credit (FTC Creditability Regulations).

The far-reaching Notice allows taxpayers to claim a foreign tax credit for many foreign taxes that may not have been creditable under the FTC Creditability Regulations.

Highlights of the Notice include the following:

- For a specified relief period, taxpayers may determine whether a foreign tax qualifies as an "income tax" by applying the version of Reg. Section 1.901-2(a) and (b) (Prior FTC Regulations) that preceded the FTC Creditability Regulations. The FTC Creditability Regulations otherwise apply to tax years beginning on or after 28 December 2021. The relief period includes tax years beginning on or after 28 December 2021, and ending on or before 31 December 2023.

- For purposes of applying the Prior FTC Regulations, the Notice modifies the non-confiscatory gross basis tax rule to limit gross basis taxes qualifying as income taxes to taxes on investment income. As a result, gross basis taxes (including digital services taxes) would be creditable only to the extent that they were treated as an "in lieu of" tax under Section 903.
- The Notice allows taxpayers to determine whether a foreign tax qualifies as an "in lieu of tax" for purposes of Section 903 without regard to Reg. Section 1.903-1(c)(1)(iv) and (c)(2)(iii), which generally incorporate the controversial "attribution requirement" into Section 903.
- To claim relief, taxpayers must apply the Notice to all foreign taxes (i) that they or any other person (for example, a controlled foreign corporation held by the taxpayer) pay in any relief year (a tax year ending "within" the relief period), and (ii) for which the taxpayer would be eligible to claim a credit in the relief year (applying the temporary relief). Furthermore, all members of a consolidated group must apply the temporary relief for any member to be eligible for relief.

The Notice requires several action items for taxpayers, some of which are pressing. For instance, taxpayers currently finalizing their 2022 tax returns (or, in some cases, fiscal-year 2023 tax returns) must quickly assess the impact of any additional credits, including adjustments to deemed paid credits, Section 904 calculations, GILTI and subpart F high-tax exception eligibility (and impact), and more.

Taxpayers that have already filed their 2022 tax returns may need to amend them.

The Notice indicates that Treasury continues to analyze, and is considering amendments to, the FTC Creditability regulations. Treasury is also considering whether, and under what conditions, to provide additional temporary relief beyond the relief period.

The Notice provides no relief for other aspects of the foreign tax credit regulations issued with the FTC Creditability Regulations, many of which will continue to pose significant challenges for taxpayers. For example, no relief was granted for Reg. Section 1.861-20 rules on allocating and apportioning foreign income taxes, Section 901 rules on refundable credits, or Section 905 regulations on foreign tax redeterminations.

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

The IRS on 3 April 2023 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.

Transition Tax – Section 965

US Supreme Court hears oral arguments in *Moore* transition tax case

The US Supreme Court heard oral arguments in the *Moore v. United States* tax case on 5 December 2023, in which the taxpayer argued the transition tax under Section 965 violates the Constitution›s Apportionment Clause and the Due Process Clause of the Fifth Amendment because the transition tax was a direct tax on unrealized income.

The Supreme Court announced in June 2023 that it granted the petition of *certiorari*.

Corporate

Interim guidance released on treatment of basis adjustments under Section 961(c) on inbound liquidation or asset reorganization

Treasury on 28 December 2023 issued interim guidance (Notice 2024-16) allowing domestic acquiring corporations in certain inbound liquidations and asset reorganizations (inbound transactions) to determine basis in the stock of a controlled foreign corporation (CFC) acquired in the transaction (an acquired CFC) as if a transferor CFC's basis from subpart F and GILTI inclusions (Section 961(c) basis) is adjusted basis in the acquired CFC and carries over under Sections 334(b) and 362(b).

Section 961(c) basis applies, by statute, solely for purposes of Section 951(a); conversely, basis adjustments under Section 961(a) are treated as adjusted basis for all purposes. This mismatch creates the potential for basis to be "lost," which has complicated inbound transactions for CFCs with significant previously taxed earnings and profits in lower-tier CFCs. In particular, this lost basis could result in non-economic gain upon distributions of those earnings and profits or sales of stock of those lower-tier CFCs in the future.

Notice 2024-16 covers inbound transactions only to the extent certain stock ownership thresholds are met. Domestic acquiring corporations cannot treat Section 961(c) basis as adjusted basis if:

- Money or other property (boot) exceeding 1% of the total fair value of the stock of the transferor CFC is received in the transaction
- The transferor CFC's total basis in the stock of the acquired CFC (taking into account Section 961(c) basis) immediately before the inbound transaction exceeds the total fair market value of that stock
- Stock of the acquired CFC is transferred outside of the consolidated group in a transaction described in Section 368(a)(2)(C) or Reg. Section 1.368-2(k)(1)
- Stock of the acquired corporation is transferred to a partnership or foreign corporation under a plan, which is deemed to exist for transfers within two years of the inbound transaction
- The domestic acquiring corporation(s) are regulated investment companies, real estate investment trusts or S corporations

Taxpayers may rely on the interim guidance in the Notice for transactions completed before the date of the forthcoming regulations, provided the taxpayer and all related parties consistently apply all the rules in the Notice.

IRS to broaden scope of corporate PLRs

In October 2023, the Office of the IRS Associate Chief Counsel (Corporate) reportedly indicated it would "significantly broaden" the scope of the type of private letter rulings that it is willing to consider. The new head of the IRS's corporate division was quoted as saying the majority of subchapter C transactions – including Section 351 transactions, acquisitive reorganizations and Section 332 liquidations – will become eligible for PLR requests.

The official added that he also envisions the IRS issuing PLRs on CAMT issues in the context of corporate reorganizations.

IRS proposed regulations would amend Section 367(b) regulations applying to certain cross-border triangular reorgs, inbound nonrecognition transactions

Treasury and the IRS issued proposed regulations on 5 October 2023 (REG-117614-14) Proposed Regulations) to modify certain aspects of the existing regulations issued under Section 367(b) (Existing Regulations).

The Proposed Regulations incorporate, with certain modifications, guidance described in Notice 2014-32 and Notice 2016-73 (2016 Notice and collectively, the Notices), each issued in response to transactions perceived to exploit certain aspects of the Existing Regulations.

Consistent with the 2016 Notice, the Proposed Regulations focus mainly on inbound transactions that result in repatriation of previously untaxed foreign earnings. The Preamble to the Proposed Regulations acknowledges that the *Tax Cuts and Jobs Act* (TCJA) drastically changed the US tax landscape by introducing Section 245A and increasing the amount of foreign earnings or income subject to immediate US taxation under the "GILTI" rules in Section 951A. As a result, when distributed to 10 percent US shareholders, most earnings and profits (E&P) of foreign corporations are not taxable either because they give rise to a 100% dividends received deduction or constitute previously taxed earnings and profits (PTEP).

Despite the changes made by TCJA, the IRS and Treasury believe that the regulations under Section 367(b) remain necessary because incentives to avoid treating property transfers as distributions remain (e.g., the distribution may not qualify for the dividends received deduction or the taxpayer seeks to preserve PTEP). Accordingly, the Proposed Regulations would formalize the guidance announced in the Notices but update it in light of the changes made by the TCJA.

In response to a comment received on the 2016 Notice, the Proposed Regulations would narrow the scope of the "excess asset basis" (EAB) rules specified in the 2016 Notice. Considering the increased prevalence of PTEP after the TCJA, the Proposed Regulations would also treat the foreign acquired corporation as receiving a deemed distribution under Section 301 from its foreign subsidiaries instead of adjusting an exchanging shareholder's all E&P amount as described in the 2016 Notice.

The IRS requested that comments on the Proposed Regulations be received by 5 December 2023.

IRS rules converting disregarded entity to domestic corporation does not modify debt

In PLR 202337007 (released in September 2023), the IRS ruled that a transaction in which a disregarded entity is converted into a domestic corporation did not cause a modification of debt previously issued by the entity under Reg. Section 1.1001-3. Accordingly, the transaction does not give rise to a taxable debt-for-debt exchange.

The latest ruling provides the IRS's current position on an issue that has been the subject of various private letter rulings, but which has not been addressed in a revenue ruling or other precedential guidance.

IRS proposes updating regulations on consolidated returns, discarding unnecessary guidance

The IRS on 4 August 2023 released proposed regulations (REG-134420-10) for corporations that file US federal consolidated income tax returns. The proposed rules would update guidance under Section 1502 for statutory changes made over the last 50 years, modernize and clarify language, and facilitate taxpayer compliance. The proposed regulations would also partially or completely withdraw certain notices of proposed rulemaking and temporary regulations that are no longer necessary.

Most of the proposed changes would result in cleaning up the current regulations to remove references to inapplicable provisions, incorporate current provisions, and modernize the language.

To account for recent statutory changes, the proposed regulations would modify the definition of the term "tax" in Reg. Section 1.1502-5 for purposes of computing estimated taxes to add a reference to the new corporate alternative minimum tax (CAMT) under Section 55(a) and the base erosion and anti-abuse tax (BEAT) under Section 59A. The proposed regulations did not, however, make conforming modifications in Reg. Section 1.1502-2 for purposes of computing the "tax liability" of a consolidated group.

The proposed regulations would also revise (1) Reg. Section 1.1502-9 to incorporate changes made by the foreign tax regulations (TD 9882) that provided guidance for the *Tax Cuts and Jobs Act* statutory changes and (2) Reg. Sections 1.1502-4 and -79(d) to reflect changes to the foreign tax credit carryover and carryback rules enacted since 1966.

The one substantive change proposed by the regulations would withdraw proposed regulations from 2001 (REG-137519-01) as being unnecessary to prevent duplicative stock basis reductions. The 2001 proposed regulations would have clarified that Section 358 does not reduce stock basis for the assumption of certain liabilities described in Section 357(c)(3) in intercompany Section 351 transactions despite the general inapplicability of Section 357(c) to these transactions under Reg. Section 1.1502-80(d). As a result, there would have been a single, subsequent stock basis reduction under Reg. Section 1.1502-32 when the assumed liability generated a deduction.

The preamble of the proposed regulations indicates that the withdrawal of the 2001 proposed clarification appears to shift the single stock basis reduction up front, by allowing Section 358 to reduce the basis at the time of the Section 351 transaction and prevent the subsequent investment adjustment under generally applicable, existing anti-duplication rules in Reg. Sections 1.1502-32(a)(2) and -80(a)(2).

IRS makes permanent fast-track program to resolve certain corporate PLR requests

The IRS in Revenue Procedure 2023-26 established a permanent program for fast-tracking corporate private letter rulings (PLRs) that meet certain guidelines. This program replaces the pilot program under Revenue Procedure 2022-10, with two notable changes, and applies to ruling requests received by the IRS after 26 July 2023.

In January 2022, the IRS announced that it was conducting an 18-month pilot program allowing taxpayers to request fast-track processing of corporate letter rulings if they met certain guidelines.

The permanent program, which is very similar to the pilot program, clarifies that (1) fast-track processing is not available for letter rulings that include a closing agreement; and (2) a business need for the ruling must only be stated for rulings requested with less than a 12-week timeline, although it is still necessary to state the reasons fast-track processing is being requested.

Similar to the pilot program, this permanent program will save taxpayers that need a ruling for issues under the jurisdiction of Associate Chief Counsel (Corporate) substantial time. Taxpayers must be prepared with the necessary materials requested once they begin the process, and generally must respond to requests for additional information within seven business days in order to continue with fast-track processing.

IRS plans further IP guidance

The IRS is planning to issue additional guidance regarding US inbound and outbound intellectual property (IP) transfers that will address issues not covered in recent proposed regulations.

Treasury and the IRS issued proposed regulations on 2 May 2023 that would apply new rules to "repatriations" of IP subject to Section 367(d) (See following article.) An IRS official in June was quoted as saying there will be "subsequent packages" or rules, one or more of which will relate to Section 367(d). The official did not offer a timeline.

IRS proposed regulations would turn off Section 367(d) following certain IP repatriations

Treasury and the IRS released proposed regulations (REG-124064-19; Proposed Regulations) on 2 May 2023, that would apply new rules to "repatriations" of intangible property (IP) subject to Section 367(d). In certain circumstances, the Proposed Regulations would permit the annual inclusions that Section 367(d) and its regulations require to cease. The Proposed Regulations would be effective only for IP repatriations occurring on or after the date on which the final regulations are published.

Following certain nontaxable transfers of IP to a foreign corporation, a US transferor generally must include in income annually amounts that are (1) contingent upon productivity, use and disposition of the IP; and (2) commensurate with the income that the transferee foreign corporation earns from the IP (outbounded IP) during its useful life.

The Proposed Regulations would modify the subsequent transfer rules to terminate continuing annual inclusions if two conditions are met:

- The transferee foreign corporation (TFC) repatriated the outbounded IP to a "qualified domestic person" (QDP).
- The original US transferor complied with certain reporting requirements.

The form of the IP repatriation, including the recognition of gain or loss, would not affect the applicability of the termination rule.

The Proposed Regulations would also address certain ancillary consequences of an IP repatriation (whether or not the termination rule applies). They include:

- The amount of gain required to be recognized by a US transferor
- The basis that the QDP takes in the repatriated IP
- Adjustments to the E&P of the TFC

The coming implementation of the BEPS 2.0 Pillar Two GloBE Rules, as approved by the OECD Inclusive Framework, is causing many companies to re-evaluate their operating models for owning and using IP. With the US corporate tax rate at a globally competitive 21% and the potential for lower effective tax rates under Section 250, many US companies have an incentive to simplify their operating models by repatriating IP. Uncertainty around the consequences of repatriating outbounded IP subject to Section 367(d) complicates any re-evaluation of operating models in light of global developments.

The termination rule would be a taxpayer-favorable rule removing a significant disincentive to repatriating previously outbounded IP. Taxpayers that have previously considered repatriating IP that is subject to annual inclusions under Section 367(d) have encountered ambiguity and possible "excessive taxation" caused by the current regulations.

While the Proposed Regulations are not "reliance regulations," and therefore may only be applied if finalized, taxpayers with outbounded IP should start re-evaluating IP operating models in light of BEPS and the Proposed Regulations. Taxpayers considering whether to repatriate IP subject to Section 367(d) are encouraged to consider whether the termination rule would present a repatriation opportunity that simplifies the operating model and aligns IP ownership with the functions and employees associated with the IP.

Corporate Alternative Minimum Tax (CAMT)

IRS interim CAMT guidance provides relief from possible double-counting of CFC earnings in AFSI, but possible compliance burdens

The IRS in December 2023 released Notice 2024-10, providing guidance clarifying certain provisions of the corporate alternative minimum tax (CAMT), which was enacted as part of the *Inflation Reduction Act of 2022*.

As background, the CAMT applies to an "applicable corporation" whose "tentative minimum tax" exceeds its regular US federal income tax liability plus its base erosion anti-abuse tax (BEAT) liability. An applicable corporation's tentative minimum tax equals 15% of its applicable financial statement income (AFSI) less the CAMT foreign tax credit for the tax year. AFSI refers to a corporation's net income or loss for a tax year as specified in its AFS, adjusted according to Section 56A.

LB&I initiates CAMT compliance campaign

The IRS Large Business and International Division (LB&I) now has an active compliance campaign on the CAMT, according to the LB&I's list of active campaigns. The goal of the campaign is to promote voluntary compliance and will focus on the "highest risk" CAMT issues.

Notice 2024-10 addresses the impact of certain distributions from a CFC (Covered CFC Distributions) in a taxpayer's applicable AFSI, with guidance that should significantly reduce the potential for the duplication of items in the taxpayer's AFSI.

The guidance on Covered CFC Distributions received by US Shareholders will likely be well-received by many taxpayers. Because Section 959(d) generally excludes previously taxed earnings and profit (PTEP) distributions from a CFC to its US shareholder from gross income, the Notice should allow taxpayers to exclude PTEP distributions received by US Shareholders from AFSI. This appears to be the result regardless of when the PTEP was created.

Also, the rules for Covered CFC Distributions received by CFCs from other CFCs appear intended to result in the exclusion of a significant portion of distributions from Adjusted Net Income or Loss, and consequently from the US Shareholder's AFSI after the application of Section 56A(c)(3).

The Notice allows taxpayers to rely on its rules for Covered CFC Distributions received (i) on or before the date forthcoming proposed regulations are published in the Federal Register or (ii) before 1 January 2024, regardless of when proposed regulations are published. There is no guarantee, but the general expectation is that the proposed regulations will be released in early 2024.

The guidance on Covered CFC Distributions should alleviate many taxpayers' concerns over the double-counting of CFC earnings in AFSI. The exclusions are broad — applicable to earnings generated both before and after the exactment of CAMT, and regardless of whether such amounts were previously included in AFSI under Section 56A(c)(3).

This should reduce the likelihood that CAMT creates a "lockout" effect in which taxpayers are hesitant to repatriate earnings due to concerns over increased CAMT liabilities. Furthermore, the adjustment rules in the Notice avoid, at least temporarily, the creation of a "CAMT PTEP" regime that would require the onerous tracking of a new set of CAMT attributes for each CFC.

IRS publishes additional interim guidance clarifying CAMT

The IRS on 12 September 2023 published Notice 2023-64, providing further interim guidance that clarifies certain provisions of the corporate alternative minimum tax (CAMT), enacted under the *Inflation Reduction Act of 2022*. The IRS also announced that it plans to issue proposed regulations that are consistent with the guidance in the Notice and previously issued interim guidance in Notice 2023-7 and Notice 2023-20.

The latest Notice indicates that proposed regulations are anticipated to be effective for taxable years beginning on or after 1 January 2024 and that Taxpayers may rely on the interim guidance issued in Notice 2023-64 (and prior interim guidance issued in the Notices) for taxable years beginning before that date. As the proposed regulations are not anticipated to be retroactive, Taxpayers are expected to apply reasonable interpretations of the statute and the Notices for taxable years beginning before 1 January 2024.

Among the highlights in Notice 2023-64:

Definition of "Taxpayer"

Notice 2023-64 defines "Taxpayer" as any entity identified in Section 7701 and the regulations thereunder (including a disregarded entity (DRE) under Reg. Section 301.7701-3), regardless of whether the entity meets the Taxpayer definition in Section 7701(a)(14). Presumably, the clarification that a DRE can be a separate "Taxpayer" for CAMT purposes is to accommodate the Section 56A(c)(6) adjustment.

Taxpayer's AFS determination

Section 56A provides that an adjusted financial statement (AFS) with respect to any tax year means the AFS as defined in Section 451(b)(3) or as specified in regulations or other guidance.

The guidance in Notice 2023-64 expands the definition of AFS provided in Section 451(b)(3) and underlying regulations to include certain unaudited external financial statements and a Taxpayer's federal income tax return. This expanded definition confirms that every Taxpayer is intended to have an AFS for CAMT purposes and, therefore, have adjusted financial statement income (AFSI).

Determining AFSI

In general, AFSI means the Taxpayer's financial statement income (FSI) for such tax year, adjusted as provided in Section 56A or regulations or other guidance issued under Section 56A. Notice 2023-64 clarifies that a Taxpayer otherwise may not make any adjustments to FSI in determining AFSI.

The Notice defines FSI generally as the net income or loss of the Taxpayer set forth on the income statement included in the Taxpayer's AFS for the tax year. The Notice clarifies that FSI does not include amounts reflected elsewhere in the Taxpayer's AFS, including in equity accounts such as retained earnings and other comprehensive income.

AFSI and foreign corporations

Section 56A(c)(4) provides that, in determining the AFSI of a foreign corporation, the principles of Section 882 (i.e., the rules for determining income effectively connected with a US trade or business) apply (ECI Adjustment). Notice 2023-64 clarifies that if a foreign corporation qualifies for and claims the benefits of the business profits provisions of an applicable income tax treaty, the principles of those treaty provisions apply in determining the foreign corporation's AFSI.

Notice 2023-64 clarifies the interaction of the controlled foreign corporation (CFC) Pro Rata Share Adjustment and the ECI Adjustment, providing that if a CFC is an applicable corporation, the CFC's net income for purposes of the CFC Pro Rata Share Adjustment is reduced by the amount of CFC's AFSI (i.e., the amount subject to CAMT at the CFC level).

CAMT Foreign Tax Credit (FTC)

The CAMT FTC may reduce the CAMT (if the Taxpayer chooses to credit foreign income taxes for regular US federal income tax purposes).

Creditable foreign income taxes paid or accrued by CFCs are limited to 15% of the Taxpayer's pro rata share of its CFCs' income. Creditable foreign income taxes paid or accrued by domestic corporations are not limited.

The Notice clarifies that a foreign income tax is eligible to be claimed as a CAMT FTC in the tax year in which it is paid or accrued for Federal income tax purposes by the applicable corporation or a CFC, provided the foreign income tax has also been "taken into account" on the AFS of the applicable corporation or CFC.

Importantly, consistent with the required adjustment to AFSI, the Notice provides that a foreign income tax is "taken into account" on an AFS for CAMT FTC purposes if any journal entry has been recorded in the journal used to determine the amounts on the Taxpayer's AFS (or an AFS that includes the Taxpayer) for any year to reflect the income tax.

IRS waives addition to tax for a corporation's failure to make estimated tax payments of its CAMT

The IRS issued Notice 2023-42 on 7 June 2023, waiving the addition to tax under Section 6655 for a corporation's failure to make estimated tax payments of its corporate alternative minimum tax (CAMT) under Section 55 for a tax year beginning after 31 December 2022, and before 1 January 2024 (covered CAMT year).

The IRS stated that it is waiving the addition to tax under Section 6655 only for the CAMT liability under Section 55. The IRS action is an acknowledgement of the challenges in determining whether a corporation is subject to CAMT (i.e., an "Applicable Corporation" under Section 59(k)) and the amount of a corporation's CAMT liability under Section 55.

Although corporations will not be penalized under Section 6655 for failing to make CAMT estimated payments, other additions to tax could be imposed if a corporation fails to timely pay its CAMT liability when due. For example, Notice 2023-42 states that additions to tax could be imposed under Section 6651 if payment of the CAMT liability is not made by the due date (excluding extensions) of the corporation's return.

The IRS also will modify the instructions to Form 2220, *Underpayment of Estimated Tax by Corporations*, to clarify it will not impose the addition to tax based on a corporation's failure to make estimated tax payments of its CAMT liability for a covered CAMT year. Corporations may exclude amounts attributable to CAMT from their calculation of the required annual payment.

Though the Notice provides penalty relief, it does not clarify the application of the CAMT rules.

Foreign Investment in Real Property Tax Act (FIRPTA)

IRS GLAM concludes FIRPTA regularly-traded-stock-exception test under Section 897(c)(3) applies at partnership level

The IRS Office of the Chief Counsel in May 2023 released a generic legal advice memorandum (AM 2023-003 or GLAM) that addressed the application of the regularly-traded-stock-exception test under Section 897(c)(3) to stock of a United States real property holding corporation (USRPHC) held by a partnership.

Section 897(a)(1) was enacted as part of the *Foreign Investment in Real Property Tax Act of 1980* (FIRPTA). FIRPTA takes into account any gain or loss of a nonresident alien individual or foreign corporation from the disposition of a United States real property interest (USRPI) as if the taxpayer were engaged in a US trade or business and the gain or loss were income effectively connected with that trade or business. The foreign owner must also file a US federal income tax return. A USRPI includes an interest in a USRPHC. If a USRPHC is publicly traded, its stock is only a USRPI for a "person" who owns more than 5% of the stock (10% for real estate investment trusts (REITs)).

The IRS concluded that the ownership test should apply at the partnership level (an entity approach). Before the GLAM, it was unclear whether the IRS viewed the regularly traded stock exception test to apply at the partner or partnership level.

A GLAM cannot be cited as precedent and merely reflects the position of IRS counsel. Nevertheless, taxpayers that invest in regularly traded USRPHCs through partnerships should consider this GLAM's impact on their current and past positions, especially those for which application of the regularly-traded-stock-exception test at the partnership level would yield a different result than the taxpayer has historically taken.

Nonresident partners should also be mindful of partner-to-partnership attribution under Section 318, which may cause the partnership's interest to exceed the 5% threshold under the regularly-traded-stock-exception test.

IRS proposed regulations would make major changes to domestically controlled QIE rules under Section 897, and certain controlled commercial entity rules under Section 892

The IRS published proposed regulations (REG-100442-22) on 29 December 2022 that address whether qualified investment entities (QIEs), which include real estate investment trusts (REITs), are considered domestically controlled for purposes of the *Foreign Investment in Real Property Tax Act* (FIRPTA) rules of Section 897.

In a move that was bound to create significant controversy, the proposed regulations would apply a look-through approach to certain US C corporations to determine whether foreign persons directly or indirectly hold a QIE's stock. In particular, look-through treatment would apply to a privately held domestic C corporation if "foreign persons" (as defined in the proposed regulations) own, directly or indirectly, 25% or more of the fair market value of its stock.

The proposed regulations also address the treatment of qualified foreign pension funds (QFPFs) and qualified controlled entities (QCEs) in determining whether a QIE is domestically controlled. The proposed regulations would treat QFPFs and QCEs as foreign persons for this purpose. This is the case even though QFPFs and QCEs are not subject to the Section 897(a) FIRPTA tax under Section 897(l), which led some to argue QFPFs and QCEs should be treated similarly to domestic tax-exempt persons, which the proposed regulations would treat as domestic persons for purposes of these rules, rather than foreign persons.

The proposed regulations would only be effective for dispositions of QIE stock occurring after the date final regulations are issued. According to the preamble, however, the IRS may challenge positions contrary to the proposed regulations before the final regulations are issued.

Further, and perhaps more concerning, the proposed regulations would apply to determine whether a QIE has been domestically controlled throughout the entire testing period (generally five years) before the sale of its stock, even for the portion of the testing period that occurs before the regulations' finalization. This approach, if adopted, could severely limit a QIE's ability to proactively cure, before the effective date, any failure of domestically controlled status that the proposed regulations would create.

The practical implications of the domestically controlled QIE provisions of these proposed regulations, if finalized in their current form, would be very broad and very significant for investment structures that involve domestically controlled REITs with taxable foreign owners.

Even measuring their potential impact could require considerable time and effort, e.g., reviewing side letters where fund sponsors have agreed to structure a REIT as domestically controlled, determining who the ultimate owners of a foreign-owned domestic corporation would be, determining what 25% of the FMV of a domestic corporation would be at any given time during a testing period whose starting point is not yet known, or determining whether restructuring is desirable in light of the proposed rules.

The proposed regulations also address the treatment of QFPFs and QCEs for purposes of the US tax exemption for income of foreign governments under Section 892.

The proposed regulations would change the Section 892 regulations so that a foreign corporation that is a QFPF or a QCE and also a US real property holding corporation (USRPHC) would not be treated as engaged in commercial activities and could thus qualify for the Section 892 exemption, if other relevant criteria were satisfied. A similar rule would apply to a foreign corporation that is controlled by a foreign government and would be a USRPHC solely because it owns direct or indirect interests in other corporations that are not controlled by the foreign government.

The proposed regulations were published concurrently with final regulations on qualifications for QFPFs and QCEs under Section 897(l) and related withholding provisions.

Final regulations issued for qualified foreign pension funds contain some favorable clarifications

In 2015, Congress amended Section 897 to create a new exemption under Section 897(l) for US real property interests (USRPIs) held by qualified foreign pension funds (QFPFs) or an entity wholly owned by a QFPF. Treasury and the IRS published final regulations (T.D. 9971) on 29 December 2022 that address the qualification for the exemption. The final regulations also address gain from distributions described in Section 897(h), as well as related withholding requirements under Sections 1445 and 1446.

The final regulations retain the general approach of the proposed regulations that were published on 6 June 2019, with few substantive changes, but some helpful clarifications.

The final regulations generally apply to dispositions of USRPIs and distributions described in Section 897(h) occurring on or after 29 December 2022, although certain provisions apply to distributions of USRPIs described in Section 897(h) occurring on or after 6 June 2019. An eligible fund may choose to apply the final regulations to dispositions and distributions occurring on or after 18 December 2015 and before 29 December 2022, provided that it applies the rules consistently for all relevant years.

Tax treaties

IRS updates list of treaties

The IRS issued Notice 2024-11 on 28 December 2023, updating "the list of treaties that meet the requirements of Section 1(h)(11) (qualified dividends)." The Notice adds the new US treaty with Chile and removes the US treaties with Russia and Hungary.

US Treasury announces entry into force of the US-Chile tax treaty

The United States and Chile in December 2023 exchanged instruments of ratification for the first-ever US-Chile income tax treaty.

The treaty entered into force on 19 December 2023, when the US notified Chile that it had satisfied all applicable procedures to bring the treaty into force.

For taxes withheld at source, the treaty will have effect for amounts paid or credited on or after 1 February 2024. For all other taxes, the treaty will have effect for tax periods beginning on or after 1 January 2024.

US, Uruguay sign TIEA

The US and Uruguay signed a tax information exchange agreement (TIEA) on 24 October. TIEAs allow the US competent authority and their bilateral counterpart to exchange information on tax matters in regard to the administration and enforcement of domestic tax laws.

The US Senate gave its advice and consent to ratify the treaty, including two reservations concerning Section 59A (the Base Erosion and Anti-abuse Tax) and Article 23 (Relief from Double Taxation). Provisions relating to the reservations were subsequently approved by the Chilean Congress.

Significant provisions of the treaty include:

- Reduced withholding tax rates on certain payments of dividends, interest and royalties
- A permanent establishment (PE) provision that deems a PE to exist from the provision of services under certain circumstances
- A limitation-on-benefits provision that includes a "headquarters company test" and a triangular provision
- Provisions on the sale of shares or other rights in Chilean resident companies
- Provisions providing for exchange of information between the tax authorities of the United States and Chile

US-Chile tax treaty's US reservations reflect current policy

A Treasury official in October 2023 said that US reservations to the new US-Chile tax treaty, which were also integrated into the language of the US-Croatia Treaty signed in 2022, reflect current policy and are included in the working model of the US Model Treaty. The reservations in the Chilean accord address the Section 59A base erosion and anti-abuse tax and the application of foreign tax credits. The official was quoted as saying there are no plans to release the next iteration of the US Model Treaty, but that the proposed 2022 US-Croatia tax treaty can serve as a good indication of positions in the new US Model Treaty.

Russia suspends US-Russia, other tax treaties

Russia on 8 August 2023 reportedly suspended certain double tax treaty benefits with countries that Russia designates as "unfriendly states." According to press reports, Russian President Putin signed a decree on 8 August suspending certain provisions in tax treaties with 38 countries, including the United States, Canada, the United Kingdom and Australia.

Press reports also indicate that the suspension will remain "until foreign states eliminate the violations they have committed of the legitimate economic and other interests of the Russian Federation, the rights of its citizens and legal entities."

US negotiating tax agreements with Israel, Switzerland and Norway

US and Israeli tax treaty negotiations are moving in the direction of a new tax treaty, rather than a protocol to the existing treaty, according to a Treasury official quoted in May 2023. The current US-Israel tax convention was signed in 1973 and amended in 1980 and 1993, and does not reflect current US tax treaty policy, the official said.

Tax treaty negotiations with Switzerland are ongoing, according to the official, and are expected to result in a new protocol, rather than a new treaty. Productive negotiations have been progressing over recent months although several issues reportedly remain outstanding.

The Norwegian government also is reporting that it is in negotiations with the United States regarding a new income tax treaty. A new treaty would replace the existing 1971 convention, amended by a 1980 protocol.

US-Hungary treaty termination effective 8 January 2023

On 8 July 2022, Treasury officially began the process of terminating the US-Hungary Tax Treaty (signed in 1979). According to the Treasury Press Release, termination of the treaty was effective on 8 January 2023, and with respect to taxes withheld at source, the convention shall cease to have effect on 1 January 2024. On 27 December 2022, the text of a joint statement between the US and Hungary was posted on the IRS Country-by-Country (CbC) Reporting Jurisdiction Status Table.

The Statement acknowledges that the 2018 Agreement on Exchange of Country-by-Country Reports is expected to terminate on 8 January 2023 and provides that the US and Hungary are in the process of negotiating an intergovernmental agreement and competent authority arrangement to allow for the automatic exchange of CbC Reports. Prior to entry into force of these agreements, the Statement outlines agreements reached with respect to exchange of CbC Reports for fiscal years commencing 1 January 2021.

Capital markets

IRS issues proposed regulations on QBUs, including simplified elections for determining Section 987 gain or loss but restrictions on loss recognition

Treasury and the IRS on 9 November 2023 released proposed regulations (REG-132422-17) under Section 987 with guidance on determining taxable income or loss and currency gain or loss with respect to a qualified business unit whose functional currency differs from its tax owner (a Section 987 QBU).

The proposed regulations provide welcome guidance on the application of Section 987.

The proposed rules retain the basic approach and structure of the regulations finalized in 2016 and 2019, including the foreign exchange exposure pool (FEEP) method, while adopting simplifications, including elections to (1) treat all items of a Section 987 QBU as marked items (subject to a loss suspension rule) (the Current Rate Election), and (2) recognize all foreign currency gain or loss with respect to a Section 987 QBU on an annual basis (the Annual Recognition Election).

The proposed regulations also include new transition rules, which require the computation and disclosure of pre-transition Section 987 gain or loss, but generally delay the recognition of any such pre-transition gains and losses.

With the proposed regulations, Treasury and the IRS apparently are seeking to strike a balance between reducing the compliance burden on taxpayers while addressing concerns over the selective recognition of Section 987 losses.

Once finalized, the proposed regulations (and the parts of the 2016 final regulations and the 2019 final regulations that are not replaced or modified by the proposed regulations) would apply to tax years beginning after 31 December 2024.

To prevent taxpayers from avoiding the application of the proposed regulations by terminating Section 987 QBUs, the proposed regulations would apply beginning on the day a Section 987 QBU terminates on or after 9 November 2023. This date would also apply to terminations resulting from an entity classification election that is made on or after 9 November 2023, and effective before that date, if the 2016 final regulations and the 2019 final regulations would not apply to the Section 987 QBU. Thus, a Section 987 QBU that terminates on or after 9 November 2023, is subject to the loss deferral rules. Finally, all taxpayers with Section 987 QBUs are currently subject to the deferral rules of Reg. Section 1.987-12.

Taxpayers (and each member of their consolidated group) and their controlled foreign corporations may choose to apply the proposed regulations in their entirety to a tax year and all subsequent tax years beginning on or before 31 December 2024.

Although the regulations would generally not apply until tax years beginning after 31 December 2024 (unless early adopted), taxpayers should begin to take various steps in anticipation of transitioning to the new rules.

First, taxpayers should determine whether they have applied an eligible pre-transition method under Section 987 for each of their Section 987 QBUs, calculate the amount of pre-transition gain or loss with respect to their Section 987 QBUs, and gather supporting documentation.

Taxpayers that have not applied an eligible pre-transition method will have to compute annual unrecognized Section 987 gain or loss under the proposed regulations for each year since the inception of the Section 987 QBU until the transition date. Taxpayers should begin preparing now to address the substantial compliance burden.

Second, taxpayers should carefully monitor whether any Section 987 QBUs are terminated on or after 9 November 2023, including terminations resulting from check-the-box elections made after 9 November 2023, but effective before that date.

Such terminating Section 987 QBUs must immediately transition to the proposed regulations, which may result in the deferral of Section 987 losses.

Taxpayers should also begin to consider whether the default FEEP Method or simplifying elections are the most optimal way of applying the proposed regulations.

Turkish Lira's hyperinflationary status has federal tax implications for US multinationals

US multinationals should be aware that the determination of hyperinflationary status for the Turkish Lira (TRY) has US federal tax consequences.

Inflation data published by the International Monetary Fund confirms that the cumulative inflation rate for the TRY exceeded 100% for the 36 calendar months ended 31 December 2022.

Given that the TRY now qualifies as hyperinflationary under Reg. Section 1.985-1, taxpayers and qualified business units (QBUs) that use the TRY as their functional currency must adjust their taxable income and/or earnings and profits for their 2023 tax year. Adjustments for the TRY's hyperinflationary status could trigger gains and losses for these taxpayers and affect previously calculated deemed inclusions for US shareholders of controlled foreign corporations.

The TRY's hyperinflationary status could also require certain taxpayers and QBUs with TRY nonfunctional currency-denominated transactions to mark those transactions to market for their 2022 tax year, while also affecting their eligibility for potential exceptions and elections under US federal income tax regulations.

Cryptocurrency and NFTs

IRS issues proposed regs on broker reporting requirements for digital asset sales and exchanges

The IRS on 25 August 2023 released proposed regs (REG-122793-19) that would require brokers, including digital asset trading platforms, digital asset payment processors and certain digital asset hosted wallets, to file information returns on certain sales or exchanges of digital assets. Brokers would also have to provide payee statements to customers on a new Form 1099-DA to inform them of the transactions being reported to the IRS.

The 282-page regulations would apply to sales or exchanges of digital assets that take place on or after 1 January 2025. In addition, the proposed regs require brokers to include gain or loss and basis information for certain sales that take place on or after 1 January 2026. Written comments on the proposed regs must be submitted by 30 October 2023; a public hearing has been scheduled for 7 November 2023.

The IRS notes that digital assets have grown in popularity both as a payment method and as an investment or trading asset. According to a GAO report cited in the preamble, limits on third-party information reporting to the IRS generally are an important factor contributing to the tax gap (the difference between taxes legally owed and taxes actually paid.)

Cryptocurrency stakers must include rewards in gross income upon gaining control

The IRS in August 2023 published Revenue Ruling 2023-14, announcing that taxpayers using the cash-method of accounting must include the rewards from cryptocurrency staking in gross income in the year they gain control of the rewards.

As background, holders of cryptocurrency native to a proof-of-stake blockchain can receive rewards of newly-created units of that cryptocurrency by participating in a proof-of-stake consensus mechanism, where the holders "stake" their holdings and validate new blocks on the blockchain.

The IRS concluded that cash-method taxpayers that stake cryptocurrency native to a proof-of-stake blockchain, either personally or through a cryptocurrency exchange, and receive rewards of additional units of cryptocurrency, must include the fair market value of the rewards in their gross income in the tax year in which they gain dominion and control over those rewards.

Revenue Ruling 2023-14 is broadly consistent with the IRS's position in Notice 2014-21 that those earning cryptocurrency as payment for goods or services (e.g., mining) must include the fair market value of the cryptocurrency as of the date that the virtual currency was received when computing gross income.

The ruling does not address the significant cross-border issues involving staking rewards, such as whether receipt is subject to withholding or how the income is characterized in the hands of a controlled foreign corporation.

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

The IRS on 24 April 2023 released Notice 2023-34, updating earlier guidance (in 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.

Under Notice 2014-21, cryptocurrency is generally considered "virtual currency" and treated as property. Thus, tax principles for property transactions, rather than currency transactions, apply to transactions involving cryptocurrency.

The modification in Notice 2023-34 does not change the IRS's view that "convertible virtual currency" is not a currency and cannot generate foreign currency gain or loss for US federal tax purposes. The IRS explained that the change to Notice 2014-21 does not affect the answers to the frequently asked questions (FAQs) in Section 4 of the Notice, specifically noting Q&A-2, which concludes that convertible virtual currency is not treated as currency that could generate foreign currency gain or loss for US federal tax purposes.

Taxpayers may have inferred from Notice 2014-21 that a digital currency would be treated as currency for US tax purposes if it became accepted as legal tender in another jurisdiction. The modification clarifies that another jurisdiction's adoption of a digital currency as legal tender is for a "limited purpose" and does not render that digital currency a "currency" for US federal income tax purposes.

IRS in Chief Counsel Advice 202316008 finds change in blockchain protocol not taxable event

In CCA Memorandum 202316008, the IRS concluded that a cryptocurrency owner did not have taxable income when the native blockchain of that cryptocurrency underwent a protocol upgrade with no change to the owner's cryptocurrency.

The IRS memorandum does not label the cryptocurrency being discussed, however, given that Ethereum recently completed the "Merge," a highly publicized transition to the proof-of-stake consensus mechanism in September 2022, the CCA may be addressing a taxpayer who held Ethereum tokens during the Merge.

CCA 202316008 is helpful in providing guidance on the factors that a taxpayer should consider when determining whether a particular event involving a blockchain protocol results in a realization event.

IRS announces plans to issue guidance on certain NFTs as collectibles

The IRS issued Notice 2023-27 on 21 March 2023, announcing that Treasury and the IRS intend to issue guidance related to the treatment of certain nonfungible tokens (NFTs) as collectibles for tax purposes. Pending the issuance of that guidance, the IRS intends to determine whether an NFT constitutes a Section 408(m) collectible by analyzing whether the NFT's associated right or asset is a collectible, under a look-through analysis.

While some NFTs may represent a right or asset explicitly listed under Section 408(m), such as gemstones, other assets may require further clarification in the ensuing guidance. In particular, the IRS will make a determination on the extent to which a digital file may constitute a "work of art" under Section 408(m)(2)(A). Notice 2023-27 requests comments on specific questions offering taxpayers the opportunity to provide technical input on future guidance.

The IRS has not previously issued income tax guidance specific to NFTs. Notice 2023-27 is significant in that it is the first of its kind and may help start a discussion around the proper tax treatment of NFTs.

By expanding the definition of "collectibles" to include certain NFTs, the Notice confirms that a 28% tax rate will apply to sales of these NFTs, as well as gain from the sale of an interest in a trust, S corporation or partnership attributable to an NFT.

The forthcoming guidance may also provide a much-needed framework for state departments of revenue as they try to issue guidance around the proper treatment of digital assets, including NFTs. While a handful of states have issued published guidance on cryptocurrencies and NFTs in the context of sales tax, most state taxing authorities have held back on issuing tax guidance specific to blockchain-based digital assets.

IRS addresses deductions involving cryptocurrency in two Chief Counsel Advice memos

In two January 2023 released Chief Counsel Advice (CCA) Memoranda, the IRS issued "non-specific taxpayer" advice involving cryptocurrency transactions, both concluding that cryptocurrency is not a "security" under Section 165(g)(2).

In CCA 202302011, the IRS determined that a taxpayer could not claim a loss deduction for cryptocurrency that had lost almost all its value. The CCA concludes that the cryptocurrency in question could not be considered worthless because it had some value (albeit less than one cent). This conclusion is consistent with historical case law and is not surprising.

In CCA 202302012, the IRS determined that a taxpayer could not claim a charitable deduction for a donation of cryptocurrency that had not been independently appraised. The regulations support the IRS's position that a qualified appraisal is required. Taxpayers have encountered a similar issue with donations of publicly traded partnerships for decades.

One practical difficulty not addressed by the CCA is how to actually obtain a qualified appraisal of cryptocurrency.

Transfer pricing

IRS appeals Tax Court's latest decision in *Medtronic*

The IRS in the fall appealed the decision issued by the US Tax Court in *Medtronic, Inc. and Consolidated Subsidiaries v. Commissioner (Medtronic III)* to the Court of Appeals for the Eighth Circuit. The decision was issued in accordance with the Tax Court›s decision on 18 August 2022, which applied an unspecified method to determine the royalty rate for a license agreement between Medtronic Inc. (Medtronic US) and its Puerto Rican subsidiary.

The basis for the IRS's appeal is not explained in the Notice of Appeal.

In the latest decision, the Tax Court determined income tax deficiencies for tax years 2005 and 2006 of approximately $175 million, plus interest.

The Tax Court opinion in *Medtronic III* has provided guidance for related-party transactions by rejecting the Comparable Uncontrolled Transaction (CUT) and Comparable Profits Method (CPM) as the best method and instead applying an unspecified method. When the Eighth Circuit ultimately rules on the IRS's most recent appeal of the Tax Court's decision, it will provide important future precedent.

US, Israel sign CAA on exchange of CbC reports

The US and Israel signed a competent authority agreement (CAA) on 16 August 2023 on the exchange of country-by-country (CbC) reports, operative on the same date. The exchange of CbC information is based on the information exchange provision in the 1975 US-Israel tax treaty.

Under the terms of the CAA, CbC reports are first to be exchanged for fiscal years (FYs) of multinational groups beginning on or after 1 January 2021, "as soon as possible and no later than 18 months after the last day of the Fiscal Year of the MNE Group to which the CbC Report relates." CbC reports for FYs beginning on or after 1 January 2022 are to be exchanged as soon as possible but not later than 15 months after the close of the FY of the multinational group to which the report relates.

Cyprus issues clarification note on future CbC exchange agreement with US

The Cypriot Tax Department publicly announced that the bilateral Competent Authority Agreement (CAA) for the exchange of Country-by-Country (CbC) reports between Cyprus and the United States — which is still under negotiation — is expected to be effective for Reporting Fiscal Years (RFYs) starting on or after 1 January 2023.

According to the announcement, the secondary filing mechanism for a Cypriot Constituent Entity (CE) of a multinational enterprise group with a US tax resident Ultimate Parent Entity (UPE) is triggered for RFYs starting on or after 1 January 2022, but before 1 January 2023 (i.e., during calendar year 2022).

Accordingly, a Cypriot CE whose UPE is a tax resident in the US, must file the CbC report locally in Cyprus for its RFY ending on 31 December 2022, even if a CbC report has or will be submitted in the US.

Treasury official states US preference on transfer pricing rules

A Treasury economist in September 2023 explained that the US government continues to prefer the adoption of "Alternative A" instead of "Alternative B" in the scoping rules for Amount B of BEPS Pillar One. Amount B provides for fixed returns for in-scope in-country baseline marketing and distribution activities. The key differentiator between the two alternatives – A and B – is whether an additional qualitative scoping criterion is required. Alternative A includes no additional qualitative scoping exclusions.

Hungary authorizes new CAA with US on exchange of CbC reports

The Hungarian government reportedly has authorized the signing of a new Hungary-US competent authority agreement (CAA) for the automatic exchange of country-by-country reports, according to a Hungarian Decree published in the *Official Gazette* on 2 November. A prior 2018 agreement was terminated effective on 8 January 2023, the same day that the Hungary-US income tax treaty was terminated.

IRS announces intent to issue proposed regulations for Section 174, would affect cost sharing arrangements

Treasury and the IRS issued Notice 2023-63 (Notice) on 8 September 2023, describing rules that the IRS is considering for inclusion in proposed regulations under Section 174, as amended by the *Tax Cuts and Jobs Act* (TCJA). The guidance also covers the treatment of SRE expenditures (a new term replacing the term "research or experimental expenditures") under Section 460, as well as the application of Section 482 to cost-sharing arrangements that involve SRE expenditures.

The proposed regulations would be effective for tax years ending after 8 September 2023.

Section 174(a)(2) requires taxpayers to charge SRE expenditures to a capital account. Taxpayers must amortize the expenditures over five years (15 years if the SRE expenditures relate to foreign research within the meaning of Section 41(d)(4)(f)), beginning with the midpoint of the tax year in which taxpayers pay or incur the SRE expenditures. Section 174, as amended, applies to SRE expenditures paid or incurred in tax years beginning after 31 December 2021.

Among other things, Notice 2023-63 addresses the effect of Section 174 on Reg. Section 1.482-7 cost sharing arrangements and provides interim guidance to taxpayers on proposed regulations that will revise Reg. Section 1.482-7(j)(3)(i).

Per the Notice, Treasury and the IRS anticipate issuing proposed regulations that will replace the current regulatory text with rules providing that cost sharing payments owed to a participant reduce (1) the category of intangible development costs (IDCs) borne directly by that participant that must be charged to a capital account; and (2) the category of IDCs borne directly by that participant that are not described in the Notice and are deductible.

The Notice also illustrates the ordering principle of how cost sharing payments from the payor reduce the payee's IDC.

Taxpayers subject to the cost sharing rules under Section 482 should review Notice 2023-63 and assess whether the anticipated revisions to Reg. Section 1.482-7(j)(3)(i) align with how they are capitalizing IDCs under Section 174.

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

The IRS's Acting Director of Treaty and Transfer Pricing Operations (TTPO) informed IRS employees of new internal procedures for advance pricing agreement (APA) prefiling 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 prefiling 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 now engages 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.

IRS considering Section 482 regulation for parent's implicit support in pricing intercompany loans

The IRS has indicated that it is considering the overarching issue of whether intercompany debt should be priced solely on the borrower's credit rating or using a group approach where a parent would support the borrower if a financial need existed (i.e., implicit support).

An IRS official in March 2023 was quoted as saying that the agency is considering issuing a regulation that would clarify that parental support of a subsidiary's intercompany loan must be considered when pricing the loan. In addition, the IRS's priority guidance plan for 2022/23 listed a project on clarifying the effects of group membership (e.g., passive association) on arm's-length pricing for financial transactions. According to the official, a clarifying regulation could require taxpayers determining the interest rate on an intercompany loan to account for a parent's implicit support when rating a subsidiary borrower, just like a credit agency would, even if that support does not entitle the parent to a corresponding fee. This would align with the OECD transfer pricing guidelines.

The official further explained that the likelihood that parental support might increase the credit rating of a borrower should be considered in pricing the loan, acknowledging that such an impact varies based on the relative importance of the borrower to a group or to the parent.

Taxpayers should closely monitor any development as any future regulation likely will impact the general approach to pricing intercompany debt when there is implicit support. Furthermore, the potential retroactivity of the clarifications could conflict with foreign jurisdictions, as they may not accept a new pricing approach for transactions already in place.

US Tax Court approves IRS/Eaton Corporation agreement resolving APA cancellation case

The US Tax Court on 3 February 2023 issued a stipulation approving an agreement between Eaton Corp. (Eaton) and the IRS to adjust Eaton's tax bill for 2005 and 2006 to \$8.8 million. The proposal follows lengthy litigation in both the Tax Court and the Sixth Circuit Court of Appeals.

The case originated with Eaton's inadvertent errors in calculating its transfer pricing methodology for its Advance Pricing Agreement (APA) annual reports in 2005 and 2006. The IRS used these inadvertent errors to justify cancelling Eaton's APAs and proposing a \$75 million adjustment plus \$51 million in Section 6662 penalties.

The Tax Court held that the IRS was not authorized to cancel Eaton's APAs and rejected the IRS's assertion of penalties. The IRS appealed the Tax Court's decision to the Sixth Circuit, but the appeals court ruled in favor of Eaton, finding that the IRS had the burden of proving that it had grounds to cancel the APAs under contract-law principles and failed to do so.

In November 2022, Chief Judge Kerrigan ordered Eaton and the IRS to submit a proposed decision on or before 20 January 2023. The proposed decision determined deficiencies of $4.7 million in 2005 and $4.6 million in 2006, with no penalties. On 3 February 2023, Chief Judge Kerrigan issued a stipulated order identical to the proposed decision, which also took into account overpayments of tax for each year to result in the final $8.8 million adjustment.

IRS examiners must consult IRS Counsel before applying economic substance doctrine in transfer pricing audits

An IRS official in mid-January 2023 told an American Bar Association Section of Taxation meeting that examiners still must consult with IRS Counsel before asserting related penalties related to the economic substance doctrine (ESD).

The statement by the Large Business and International (LB&I) Division Counsel follows an IRS decision to no longer require IRS examiners to obtain executive-level approval in order to assert the ESD under Section 7701(o) during an audit.

The ESD assesses whether: (i) a transaction impacts a taxpayer's economic position beyond the federal income tax effects; and (ii) the taxpayer had a substantial business purpose for entering into the transaction other than for federal income tax purposes. If a transfer pricing position lacks economic substance, the IRS, in addition to proposing audit adjustments, may assert Section 6662(i) penalties of up to 40%.

After guidance released in April 2022, examiners no longer have to obtain executive-level review. Instead, the official was quoted as saying "initial review and coordination of the potential assertion of the doctrine begins with field counsel advising examiners." The review "extends up the chain of command through … herself and is coordinated with the associate chief counsel for procedure and administration and briefed to the deputy chief counsel of operations."

Taxpayers should consider the ESD when planning their intercompany transactions and create contemporaneous supporting documentation. Taxpayers should also continue to focus on penalty protection measures, including transfer pricing documentation.

Withholding

Tax Court rules non-US partnership was securities dealer engaged in US trade or business, liable for partnership withholding tax

The US Tax Court in November 2023 held in *YA Global Investments, LP v. Commissioner* that a foreign partnership providing funding to certain portfolio companies was considered to have a US office because its US-based asset manager acted as its agent. Consequently, the partnership was engaged in a US trade or business and liable for withholding tax under Section 1446 on the portion of its taxable income that was effectively connected with that trade or business and allocable to foreign partners.

The court also found that the limitations period for the assessment never started because the partnership filed Form 1065, *U.S. Return of Partnership Income*, for the relevant years, but did not file Form 8804, *Annual Return for Partnership Withholding Tax (Section 1446)*.

The court concluded that the taxpayer was engaged in a trade or business beyond the Section 864(b)(2)(A) trading in stocks or securities safe harbor. The court focused on the fact that the taxpayer earned fees that were compensation for services, rather than simply earning a return on invested capital. Many alternative asset managers have sought to limit the receipt of fees by an investment fund for precisely this reason, and this case may cause funds and management companies to be even more cautious regarding the receipt of these fees.

Section 892 investors should be aware that certain portfolio fees earned by asset managers and paid to limited partners may cause the Section 892 partner to potentially be engaged in a commercial activity.

Tax administration

IRS sending compliance alerts to US subs of foreign-owned corporations

The IRS announced (IR-2023-194) on 20 October that it plans to send compliance alerts to approximately 150 US-based subsidiaries of foreign-owned corporations that distribute goods in the United States. The alerts stem from the companies' alleged use of certain transfer pricing strategies, which the IRS deems improper. The IRS also said in the news release that it plans to expand the Large Corporate Compliance program in 2024 to audit 60 additional large corporate taxpayers, which will be selected with the help of artificial intelligence.

IRS 2024 CAP program accepting new applications

The IRS's Large Business and International division (LB&I) announced (IR-2023-164) that it will accept, between 6 September and 31 October 2023, new applications for its Compliance Assurance Process (CAP) program for tax year 2024.

CAP, a cooperative pre-filing program available to certain large taxpayers, is intended to allow the IRS and taxpayers to reach agreement on the treatment of various tax issues before a return is filed. To be eligible, new applicants must: (1) have $10m or more in assets; (2) be a US publicly traded corporation legally required to submit SEC Forms 10-K, 10-Q and 8-K; and (3) not be under investigation by, or involved in litigation with, any government agency that would limit the IRS's access to current tax records. (See the IRS's CAP webpage for more information.)

Modifications for the 2024 tax year include providing a new draft form for international issues.

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 Section 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 Section 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.

IRS offers electronic request for relief for certain late-filed international documents, forms

The IRS announced on 11 August 2023 that taxpayers that are not under examination will now have a better option to electronically request relief for certain late-filed international documents and forms. The new option, part of the IRS's paperless processing initiative, will allow for eFax filings and will apply to Relief for Gain Recognition Agreements, Late Filing Relief for Dual Consolidated Losses, and Relief for Partnership Gain Deferral Contributions.

Miscellaneous

FASB modifies income tax disclosure rules

The Financial Accounting Standards Board (FASB) on 14 December 2023, issued Accounting Standards Update 2023-09 (ASU), which modifies the rules on income tax disclosures to require entities to disclose (1) specific categories in the rate reconciliation; (2) the income or loss from continuing operations before income tax expense or benefit (separated between domestic and foreign); and (3) income tax expense or benefit from continuing operations (separated by federal, state and foreign).

The ASU also requires entities to disclose their income tax payments to international, federal, state and local jurisdictions, among other changes.

The amendments apply to public business entities for annual periods beginning after 15 December 2024. For other entities, the amendments apply to annual periods beginning after 15 December 2025.

US officials offer international regulatory update

An IRS official in mid-December said proposed regulations addressing previously taxed earnings and profits (PTEP) are now expected for release in 2024.

The government also reportedly plans to finalize proposed regulations under Section 892 in 2024 that address the foreign government exemption on qualified US investments. The coming regulations reportedly will finalize both 2011 and 2022 proposed regulations as a single regulatory package.

Finally, a Treasury official confirmed the US is working on regulations to implement the OECD Crypto-asset Reporting Framework (CARF).

US headquartered FG500 companies increase, reversing downward trend

The decades-long decline in the number of the world's largest companies headquartered in the United States has begun to reverse. In 2021, the US began gaining back some of these headquarters, and in 2023 the US surpassed China as the country with the highest number of headquarters for the world's 500 largest companies by revenue (Fortune Global 500 or FG500).

Even with this recent reversal, however, the US has seen the number of companies headquartered there decline nearly 25% (from 179 to 136) between 2000 and 2023. In contrast, the number of FG500 companies headquartered in China increased more than ten-fold (from 10 to 135) over this same period. That growth, however, has appeared to level out with China's numbers holding relatively steady since 2021, and even dropping by one in 2023.

Looking at the numbers through a broader lens, the United States, China, Japan, Germany, France, and the United Kingdom have consistently ranked as the countries with the most FG500company headquarters; that is, until 2023 when South Korea surpassed the United Kingdom. The UK has experienced its own reshuffling, with the number of FG500 company headquarters located there declining more than 60% (from 38 to 15) since 2000.

Collectively, the top 10 countries (by the number of FG500 company headquarters located in the country) hosted 434 (87%) of FG500 company headquarters in 2023, up from 411 (82%) in 2010, but down slightly from 451 (90%) in 2000.

Many factors can affect a company's choice of headquarters location, such as a country's regional economic growth and stability, local infrastructure, regulatory environment, labor availability and productivity, transportation and other input costs, and tax policies.

US court denies DRD after applying economic substance doctrine

A US District Court in *US v. Liberty Global* denied a company's dividends-received deduction under Section 245A after applying the codified economic substance doctrine (the Codified ESD) under Section 7701(o).

In the 31 October decision, the court took a broad view of the Codified ESD, rejecting the company's argument that the doctrine was limited to transactions to which it is "relevant." The decision represents a timely reminder to taxpayers about the role and importance of the common law ESD, including its application to multi-step transactions.

IRS informing taxpayers of Schedule UTP non-compliance

EY is aware that the IRS had begun in mid-October, sending certain taxpayers letters stating that they have not complied with the rules for reporting an uncertain tax position (UTP). Specifically, the letters state that the Schedule UTP does not fulfill the requirements for a "concise description" for one or more reportable UTPs.

As background, in December 2022, the IRS finalized an updated Schedule UTP, *Uncertain Tax Position Statement* with accompanying instructions. The IRS uses the Schedule UTP as a tool in conjunction with other risk analysis factors to identify the highest compliance risks among taxpayers and to assist in working audit issues effectively and efficiently.

The IRS has a centralized review team that reviews and evaluates all concise descriptions of UTPs to assess compliance with the Schedule UTP instructions. The review team will contact the taxpayer when information on the Schedule UTP does not meet the instruction's requirements.

The letters issued by the IRS appear to stem from this team's review of taxpayer UTPs, and indicate the Schedule UTP is not compliant due to the lack of a concise description that includes enough detail to adequately describe the issue. The letters also forewarn that the IRS will be reviewing future Schedule UTPs, so the taxpayer must follow the form's instructions.

Senate approves Daniel Werfel as next IRS Commissioner

The Senate on 9 March confirmed Daniel Werfel to be the next IRS Commissioner for a five-year term. The 54 to 42 vote was closer than expected.

The IRS's issuance of the letters appears to be a compliance-driven effort to ensure taxpayers are reporting the appropriate UTP details. Accordingly, taxpayers should confirm that they are describing reportable UTPs with the requisite specificity to help prevent any future compliance issues.

IRS announces major new compliance initiative targeting large partnerships

The IRS on 8 September 2023 announced a major new compliance initiative that will focus increased scrutiny on large partnerships, corporations, high-income taxpayers and «promoters abusing tax rules on the books. The IRS will expand its existing Large Partnership Compliance program to additional large partnerships with the help of artificial intelligence. By the end of the month, the IRS indicated it will open exams on 75 of the largest partnerships in the US across industries with assets of more than $10 billion, on average.

According to the IRS, there will also be expanded focus on partnership issues through compliance letters. The IRS is citing "ongoing discrepancies on balance sheets involving partnerships with over $10 million in assets, which is an indicator of potential non-compliance" — specifically, discrepancies between year-end balances and beginning balances the following year. Consequently, the IRS plans to focus on "high-risk partnerships" and, beginning in early October, will begin mailing letters to approximately 500 partnerships to address the issue.

The IRS also indicated it will expand its focus on digital assets.

IRS extends FATCA penalty relief for certain dividend equivalent payments

On 25 August 2023, the IRS updated the Frequently Asked Questions on the FATCA webpage (FAQ 23 (Q23)), extending penalty relief for the 2022, 2023, and 2024 calendar years in limited situations where a withholding agent is reporting dividend equivalent amounts on transactions involving covered partnerships.

IRS temporarily relieves foreign financial institutions from reporting US TINs for certain accounts, provided various requirements are satisfied

The IRS provided temporary relief (Notice 2023-11, released 30 December 2022) to certain foreign financial institutions from the requirement to report US Taxpayer Identification Numbers (TINs) for certain accounts in existence before the effective dates of FATCA and associated Intergovernmental Agreements.

OMB's Office of Information and Regulatory Affairs will no longer review tax regulations

Treasury in mid-June 2023 announced in a Memorandum of Agreement (MOA) that tax regulations would no longer be reviewed by the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs, a practice established under the Trump Administration.

In April 2018, a prior MOA created a new framework for the review of certain tax regulations (above $100 million annual non-revenue economic impact) that was intended to increase economic analysis and review of tax rules. That added level of review established a new layer of input in the regulatory process.

IRS releases general plan for spending $80 billion over the next 10 years

The IRS announced in April 2023 (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 identified a total of 42 initiatives, indicators of success, milestones, and interdependencies. It also provided 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.

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.

US Supreme Court holds FBAR penalties apply per form, not per account

In a 5-4 decision, the US Supreme Court on 28 February 2023 held in *Bittner v. United States* that FBAR penalties in the Bank Secrecy Act (BSA) apply per form and not per account. Justice Gorsuch wrote: "Best read, the BSA treats the failure to file a legally compliant report as one violation carrying a maximum penalty of $10,000, not a cascade of such penalties calculated on a per-account basis."

The following articles are OECD BEPS-related developments over the period 1 January - 31 December 2023.

OECD

BEPS 2.0

OECD/G20 IF releases BEPS Pillar Two GloBE rules guidance, new Pillar One MLC timeline

The OECD/G20 Inclusive Framework (IF) on BEPS on 18 December 2023 released the third set of administrative guidance on the global minimum tax under Pillar Two and a statement on a new timeline for the Multilateral Convention (MLC) under Pillar One. The Agreed Administrative Guidance for the Pillar Two GloBE Rules (December) 2023 (December Guidance) follows earlier administrative guidance releases in February and July 2023.

The December Guidance addresses application of the Transitional Country-by-Country Reporting (CbCR) Safe Harbour and provides a Simplified Calculations Safe Harbour for non-material entities. It also addresses allocation of blended controlled foreign company (CFC) taxes, among other technical issues under the GloBE Rules. According to an OECD press release issued on the same day, the new Administrative Guidance will be included in a revised Commentary to the GloBE Rules to be released in 2024.

The December Guidance provides additional guidance on the Transitional CbCR Safe Harbour with respect to areas that tax administrations and Multinational Enterprise (MNE) Groups identified as requiring further clarification. The guidance also indicates that the Inclusive Framework has become aware of certain transactions that exploit differences in the source of financial information or differences between tax and financial accounting treatment to allow a Constituent Entity to qualify for the Transitional CbCR Safe Harbour. It describes these transactions as typically involving the use of arrangements in which the parties are able to account for the income, expenses, gains, losses or taxes under that arrangement in an inconsistent or duplicative manner and in a way that purports to allow one of the Constituent Entities to qualify for the Transitional CbCR Safe Harbour and thereby avoid GloBE Top-up Taxes that would otherwise arise.

In this regard, the December Guidance provides that, for purposes of determining if a jurisdiction qualifies for the Transitional CbCR Safe Harbour, adjustments must be made to the jurisdiction's Profit (or Loss) before Tax (PBT) and income tax expense with respect to any Hybrid Arbitrage Arrangements entered into after 15 December 2022. For these purposes, a Hybrid Arbitrage Arrangement is: (i) a deduction/non-inclusion arrangement; (ii) a duplicate loss arrangement; or (iii) a duplicate tax recognition arrangement. Finally, the guidance indicates that further guidance will be provided to address hybrid arbitrage arrangements in the context of applying the GloBE Rules outside the safe harbor context.

In regard to the MLC on Amount A of Pillar One, the Inclusive Framework intends to finalize the MLC by the end of March 2024, with a view to a signing ceremony by the end of June 2024.

According to the OECD press release, the OECD will release further administrative guidance on an ongoing basis in regard to various aspects of the GloBE Rules and "where necessary to address aggressive tax planning that may undermine the integrity of the rules or their application." The Inclusive Framework also plans to "develop simplifications on key compliance items," including on the application of deferred tax liability recapture rules and the allocation of deferred taxes such as CFC regimes. The guidance on simplifications is planned for the first half of 2024.

OECD announces new tax policy head

The OECD on 13 January 2023 announced that former US Treasury official Manal Corwin would become director of the Centre for Tax Policy and Administration (CTPA), replacing Grace Perez-Navarro who planned to retire in March. Perez-Navarro, who was the deputy director of the CTPA, became the director after long-time head Pascal Saint-Amans left the position in October 2022.

OECD, country officials discuss BEPS 2.0 Pillars One and Two and other OECD tax work

The US Council for International Business and the OECD held their annual tax conference in Washington, DC, on 30-31 October 2023, with the bulk of the discussion focused on developments with respect to BEPS 2.0 Pillars One and Two.

There were also sessions on the OECD's work on global mobility of workers, carbon mitigation and tax certainty.

Senior members of the OECD Secretariat participated in the conference, along with tax officials from several Inclusive Framework member countries who are responsible for their countries' participation in the tax work of the OECD.

The discussion at the conference underscored the strong political momentum with respect to Pillar Two global minimum taxes and continuing political interest in all aspects of Pillar One. It also reinforced that there continue to be divergent views among Inclusive Framework jurisdictions on aspects of both pillars.

Addressing Pillar One, US Assistant Treasury Secretary for Tax Policy Lily Batchelder said that Congress ultimately will need to approve the Pillar One Amount A multilateral convention (MLC), underscoring the critical need for input from business stakeholders during Treasury's MLC consultation, given the novel and complex design for new taxing rights in Amount A. The Treasury official said developing a consensus text is critical, with the objective being to create stability in the global tax system, eliminate digital services taxes and promote certainty.

Batchelder also reiterated the Biden Administration's support for Pillar Two and pointed to the simplification that she believes will result for US business, relating to how Pillar Two taxes are collected and the fact that other countries' Pillar Two taxes would be turned off if the US is in compliance. She added that the US continues to work with its Inclusive Framework partners on additional administrative guidance and said that an important priority for the US continues to be the treatment of the US R&D tax credit, indicating that the US continues to raise this issue in the multilateral negotiations on future guidance and that she is hopeful there will be progress.

OECD/G20 Inclusive Framework releases technical documents on BEPS Pillars One and Two

The OECD on 17 July 2023 released several technical documents on Pillars One and Two of the OECD/G20 BEPS 2.0 project. At the same time, the OECD released additional documents covering a range of international tax topics, including developments with respect to tax transparency, that were prepared for a meeting between the G20 Finance Ministers and Central Bank Governors in Gandhinagar, India on 17-18 July.

The July 2023 Guidance includes guidance on currency conversion rules for Global Anti-Base Erosion (GloBE) calculations, tax credits and the application of the Substance-based Income Exclusion (SBIE). It also includes further guidance on the design of a Qualified Domestic Minimum Top-up Tax (QDMTT) as well as providing a QDMTT Safe Harbour. In addition, it provides a Transitional UTPR Safe Harbour, as well as a report on the Subject to Tax Rule (STTR).

This is the second set of Administrative Guidance items released by the Inclusive Framework, following the release of the first set of Administrative Guidance items in February 2023. The July Guidance will be incorporated into a revised version of the Commentary that will be released later this year.

The documents released on Pillar Two were approved by the Inclusive Framework on BEPS.

More specifically, the Administrative Guidance on the Global Anti-Base Erosion (GloBE) Model Rules provides additional information on a series of technical issues and includes the two new safe harbors.

The GloBE Information Return (GIR) has been finalized and includes a transitional framework for simplified reporting on a jurisdictional, rather than entity, basis. The GIR document sets out a standard template for the GIR, a transitional simplified jurisdictional reporting framework, an approach for dissemination of the GIR and next steps.

The report on the STTR provides model tax treaty provisions and related commentary that can be used by jurisdictions to incorporate the STTR into their bilateral tax treaties.

On Pillar One, the OECD released a public consultation document on Amount B (which provides for a "fixed return" on baseline marketing and distribution activities), reflecting further developments since the earlier consultation on this topic and seeking input from stakeholders. This document does not yet reflect consensus as there are remaining open issues.

The new Administrative Guidance and the GIR are particularly significant given that the Pillar Two GloBE Rules are expected to take effect in countries around the world in 2024.

OECD releases Outcome Statement on progress on Pillars One and Two of BEPS 2.0 project

On 12 July 2023, at the conclusion of the 15th meeting of the OECD/G20 Inclusive Framework on BEPS, the OECD released an Outcome Statement reflecting the agreement reached by 138 of the 143 Inclusive Framework (IF) member jurisdictions on the remaining elements of the BEPS 2.0 project.

The July 2023 statement summarizes the Inclusive Framework deliverables in four areas:

- The Multilateral Convention (MLC) on Amount A of Pillar One
- Amount B of Pillar One
- The Subject to Tax Rule (STTR) under Pillar Two
- Plan for implementation support

In regard to Amount A in Pillar One (new nexus/taxing right), the Statement notes that the IF developed a text of the MLC for Pillar One Amount A (with a few unidentified open items), which will allow the parties to the MLC to exercise a domestic taxing right.

Members of the IF also agreed to refrain from imposing newly enacted Digital Services Taxes or relevant similar measures, as defined in the MLC, on any company between 1 January 2024 and the earlier of 31 December 2024 or the entry into force of the MLC. That moratorium is conditional, however, on having at least 30 countries — with at least 60% of the parents from in-scope companies — sign the MLC by the end of 2023. And that condition represents a major hurdle for the extension to take place.

In regard to Amount B in Pillar One (framework for the simplified and streamlined application of the arm's-length principle to in-country baseline marketing and distribution activities), the Statement says the IF achieved consensus on many aspects of that framework, although additional work remains.

The July Statement indicated the intention that the IF would approve and publish a final Amount B report by year-end, and aspects of Amount B would be incorporated into the OECD Transfer Pricing Guidelines by January 2024. In this regard, consideration would be given to both the needs of low-capacity jurisdictions and the interdependence with the signing and entry into force of the MLC.

The Statement indicates that the STTR is an integral part of the consensus on Pillar Two for developing countries. It states that work has been completed on a MLI together with an Explanatory Statement to facilitate implementation of the STTR.

IF members can elect to implement the STTR by signing the MLI or bilaterally amending their tax treaties to include the STTR when asked to do so by developing countries that are members of the Inclusive Framework. The STTR will apply to intra-group interest, royalties and a defined set of other intra-group payments that includes all payments for intra-group services. The STTR is subject to certain exclusions and materiality and mark-up thresholds and will be administered through an ex-post annualized charge.

BEPS 2.0 Pillar One

OECD official says BEPS Pillar One MLC preferable to the alternative

The Director of the OECD Centre for Tax Policy and Administration in October defended the recently released Amount A Pillar One Multilateral Convention saying it is much preferable to the alternative, which would be the enactment of hundreds of digital services taxes around the globe. Manal Corwin conceded that "simplification is not always simple," adding that without the OECD two-Pillar project, taxpayers would see the "the proliferation of multiple different measures, each with different standards and entry points and enforcement mechanisms that lead to double tax."

OECD releases text of Amount A Pillar One MLC, Treasury announces consultation

The OECD/G20 Inclusive Framework (IF) on BEPS on 11 October released the text of a new multilateral convention (MLC) that "updates the international tax framework to co-ordinate a reallocation of taxing rights to market jurisdictions, improve tax certainty, and remove digital service taxes [DSTs]." According to an OECD press release, the Multilateral Convention to Implement Amount A of Pillar One reflects the current consensus among IF members. The MLC also includes several provisions that are meant to address certain unique circumstances of developing Inclusive Framework countries.

The MLC was delivered to G20 Finance Ministers and Central Bank Governors in a new OECD Secretary-General Tax Report ahead of their October meeting in Morocco. The released MLC was accompanied by an Explanatory Statement and the Understanding on the Application of Certainty of Amount A (which describes administration and dispute resolution parameters).

Amount A of Pillar One addresses the "reallocation of taxing rights to market jurisdictions with respect to a share of the profits of the largest and most profitable multinational enterprises (MNEs) operating in their markets, regardless of their physical presence." It is also meant to ensure the repeal and end proliferation of DSTs and relevant similar measures. According to the OECD, Pillar One is expected to reallocate approximately $200 billion in profits to market jurisdictions each year, resulting in global tax revenues of between $17 billion and $32 billion, based on 2021 data.

Manal Corwin, director of the OECD's Center for Tax Policy and Administration was quoted as saying the draft MLC is considered an "intermediate step" in the process to get countries to sign the document.

The US government will not be one of the early signatories, however. Treasury Secretary Janet Yellen said the Pillar One MLC will require further negotiation before signing and that it will not take place this year.

The Treasury Secretary was quoted as saying that while the MLC reached considerable consensus and there was substantial progress in its negotiation, outstanding issues remain that will require countries to continue to work into 2024.

"There are some matters that are important to the United States and other countries that remain unresolved, open issues that still must be resolved before the treaty can be signed. So [these] processes will take into next year," the Treasury Secretary said. She added that it is very important for businesses and other stakeholders, as well as Congress, to be apprised about the MLC and ensure there is support for the convention.

In the meantime, Treasury issued a statement requesting public comments on the BEPS Pillar One MLC text and accompanying documents. According to the Treasury release, the Administration considers "release of the draft Pillar One documents a key step forward in the Pillar One negotiations. … Treasury stands behind the negotiations, which have resulted in many difficult compromises by all sides with respect to both the design of the partial reallocation of taxing rights and the elimination of discriminatory digital services taxes and similar measures."

Written comments to Treasury were due by 11 December 2023.

BEPS Pillar One to follow revised implementation plan

The BEPS 2.0 Pillar One project is expected to follow a revised, three-step implementation program, according to Manal Corwin, the new director of the OECD Centre for Tax Policy and Administration, who addressed a 12 May 2023 tax conference in Washington, DC.

According to the OECD official, the first step is agreement on the Multilateral Convention (MLC) text by the Inclusive Framework and its release. The second step will be an internal country process to determine whether domestic legislation along with the MLC is necessary and to determine politically whether the country can sign on to the convention. Step three, the OECD director said, is actual ratification by countries. Corwin also indicated there will be consideration of whether Model Rules should accompany the MLC text once it is shared.

Corwin, a former US Treasury official, suggested that 40 countries have indicated their intent to adopt Pillar Two through their own domestic legislation and praised the collaborative process with stakeholders that has influenced the drafting of the rules.

Corwin added that other tax projects before the OECD include addressing rules to minimize compliance costs and recommendations on the increasing mobility of workers, crypto assets, and carbon mitigation.

BEPS 2.0 Pillar Two

BEPS IF considering Pillar Two guidance on deferred tax assets

An OECD official in late October was quoted as saying that the Inclusive Framework on BEPS is considering issuing Pillar Two guidance on the treatment of deferred tax assets in jurisdictions with federal and subnational taxes. The official said the GloBE rules on which Pillar Two is based create a deferred tax asset in the jurisdiction in which the entity records a loss, instead of using a loss carryforward mechanism.

Upon the suggestion that it may be possible to recast the deferred tax asset at 15% accounting for both the federal and subnational level, because GLOBE rules do not distinguish between the two, he said, "We are working on this issue … . The result has to be equivalent to a 15 percent [rate]." He also reportedly said the Inclusive Framework is working on additional guidance on the treatment of deferred losses in countries that have multiple levels of taxation.

OECD/G20 Inclusive Framework launches Multilateral Convention to implement Pillar Two Subject to Tax Rule

On 3 October 2023, the OECD announced that the Inclusive Framework on BEPS had concluded negotiations on a Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule. Together with the announcement, the OECD released the STTR MLI, an explanatory statement to the STTR MLI, a summary overview including a roadmap toward signature, and a frequently asked questions document.

Inclusive Framework jurisdictions will be able to use the STTR MLI to implement the STTR in all their relevant tax treaties. Alternatively, Inclusive Framework jurisdictions can implement the STTR in a given tax treaty through bilateral negotiations.

The STTR applies to intragroup payments from source jurisdictions (i.e., the jurisdiction in which the income arises) that are subject to tax rates below 9% in the payee's jurisdiction of residence. The STTR allocates to the source country a limited and conditional taxing right to ensure a minimum level of taxation.

The STTR MLI is open for signature by all states and is subject to ratification, acceptance, or approval. No reservations are permitted, and parties must make notifications regarding the inclusion of specific annexes in Covered Tax Agreements. The STTR MLI will enter into force on the first day of the month following a period of three calendar months beginning on the date of deposit of the second instrument of ratification, acceptance or approval.

Inclusive Framework jurisdictions that have nominal corporate tax rates below 9% have committed to implementing the STTR through tax-treaty amendments when asked to do so by a developing country that is an Inclusive Framework jurisdiction.

The OECD will act as the depositary of the multilateral instrument "and will support governments in the process of its signature and ratification."

The OECD in July 2023 released a document under Pillar Two containing the model treaty provision of the STTR, together with an accompanying commentary explaining the purpose and operation of the rule. The STTR is a core element of Pillar Two.

Global minimum tax filing simplification possible, OECD official says

A senior OECD official at the end of August 2023 was quoted as saying that it is "certainly possible and likely" that there will be simplifications made to how companies file global minimum tax information used to determine minimum tax liabilities. The GloBE Information Return was finalized this summer and includes a transitional framework for simplified reporting on a jurisdictional, rather than entity, basis, in addition to specifying how the information is to be shared among jurisdictions that implement the GloBE Rules.

OECD holds public consultation meeting on compliance and tax certainty aspects of BEPS Pillar Two global minimum tax

The OECD on 16 March 2023 held a virtual consultation meeting on the public consultation documents that had been released by the OECD Secretariat on 20 December 2022 on the Pillar Two global anti-base erosion (GloBE) information return and on tax certainty for the Pillar Two GloBE rules in connection with the ongoing BEPS 2.0 project.

During the consultation meeting, three panels of business representatives and an academic discussed tax certainty and two panels of business representatives discussed the GloBE information return. The panels on tax certainty focused on why tax certainty is important for the implementation of the GloBE rules and how differences/issues in the application of the rules can be prevented or resolved. The panels on the GloBE information return focused on simplification of the data points and the return as well as standardization of administration.

OECD releases additional administrative guidance on BEPS 2.0 Pillar Two

The OECD/G20 Inclusive Framework on 2 February 2023 released a long-awaited package of additional administrative guidance under BEPS 2.0 Pillar Two. The package was to be incorporated into a revised version of the Commentary to be issued later, replacing the original Commentary released in March 2022. The guidance was adopted by the 142-member OECD/G20 Inclusive Framework on BEPS.

The additional guidance — together with the December 2022 releases (i.e., safe harbors, penalty relief, information return and tax certainty) — finalizes the Implementation Framework set out in October 2021. The Executive Summary acknowledges that further guidance will be needed, on an ongoing basis, as countries implement the Pillar Two rules and issues arise after the rules are legislated into their domestic laws. The release explains that the items addressed are those most in need of immediate clarification and simplification.

Among the areas in the new guidance that may be most significant are: (i) the treatment of certain non-refundable tax credits that flow through a tax transparent entity and that arise from an equity method investment, including the low income housing tax credit and many renewable energy tax credit investments; (ii) allocation of taxes arising under the US global intangible low-taxed income (GILTI) and other blended controlled foreign company (CFC) regimes; and (iii) the design elements for Qualified Domestic Minimum Top-up Taxes (QDMTTs) that will be used for assessment of whether a domestic minimum tax meets the requirements for qualified status, and specific rules relating to the QDMTT.

The guidance sets out minimum standards for the QDMTT and makes clear that the tax base and the rate for QDMTTs can be different than under the rules governing Income Inclusion Rules (IIRs). QDMTTs can deviate from the global anti-base erosion (GloBE) rules but generally must produce a tax rate that equals or exceeds the GloBE's 15% minimum rate.

As expected, a QDMTT must exclude tax paid or accrued by domestic Constituent Entities with respect to the income of foreign Constituent Entities under its own CFC or taxable branch regimes. Therefore, GILTI and subpart F taxes cannot be pushed down to impact the effective tax rate in the case of QDMTTs.

The US Treasury praised the release, with a senior Treasury official describing the guidance as providing "certainty for green energy tax incentives, support [for] coordinated outcomes and provide[s] additional clarity that stakeholders have asked for." A Treasury statement said certainty was also provided on "clear and administrable treatment of taxes paid under the existing U.S. GILTI global minimum tax regime" and refers to a consensus statement by all Inclusive Framework members that Pillar Two "was intentionally designed so that top-up tax imposed in accordance with those rules will be compatible with common tax treaty provisions."

OECD's Pillar Two administrative guidance raises implications for US multinationals

The OECD/G20 Inclusive Framework on BEPS on 2 February 2023 released administrative guidance on the Pillar Two GloBE Rules (the Administrative Guidance or AG). The AG supplements the previously issued GloBE Model Rules (Model Rules or MR) and Commentary.

Certain provisions of the AG will particularly impact US multinational enterprises (MNEs) due to unique rules under US GAAP and the Internal Revenue Code:

- US GAAP and common control transactions (AG Article 2.1)
- Overall domestic loss recapture and foreign tax credit carryforwards resulting from US losses offsetting US GILTI/subpart F income (AG Article 2.8)
- "Push down" of GILTI taxes to Constituent Entities and interaction of GILTI with Qualified Domestic Minimum Top-up Taxes (AG Article 2.10 and 5.1.3)
- Inclusion in GloBE of stock gains/losses — equity-investment-inclusion election (AG Article 2.9)
- Tax equity investments — Qualified flow-through tax benefits (AG Article 2.9)
- Treatment of pre-GloBE foreign tax credit and general business credit carryforwards (AG Article 4.1)
- Application of intercompany transfer transition rule to US GAAP common control transactions (AG Article 4.3)

While formulated as revisions to the Pillar Two Commentary issued in March 2022 (Commentary), the Administrative Guidance includes numerous new substantive rules and certain wholesale changes to specific MR provisions.

As such, it appears that substantive changes to the rules can be made through Administrative Guidance (in the form of revisions to the Commentary).

Tax treaties

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.

OECD release manual on MAPs and APAs

The OECD Forum on Tax Administration on 1 February 2023 released the "Manual on the Handling of Multilateral Mutual Agreement Procedures and Advance Pricing Agreements." The manual is meant to act as a "guide to multilateral MAP and APA processes from both a legal and procedural perspective."

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.

Transfer pricing

OECD releases outcomes of sixth peer review on BEPS Action 13 on CbCR

On 25 September 2023, the OECD published a compilation of the outcomes from the sixth annual peer review of the minimum standard on BEPS Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting). The Compilation covers 136 jurisdictions and reflects a finding that implementation of country-by-country reporting (CbCR) is largely consistent with the Action 13 minimum standard.

According to the press release, a large number of the recommendations made in the first five peer review phases have now been addressed by jurisdictions. However, 60 jurisdictions still have at least one recommendation outstanding.

OECD releases revised methodology for BEPS Action 14 peer reviews, updates on reporting of MAP and APA statistics

In late January 2023, the OECD and G20 Inclusive Framework on BEPS released: (i) a New Assessment Methodology for continuing the peer review process with respect to BEPS Action 14 on improving the MAP that seeks to increase efficiencies and improve dispute resolution timelines; (ii) new data points to be reported in the annual MAP Statistics; and (iii) the creation of a new annual framework for reporting APA Statistics.

Preferential tax regimes

OECD releases 2023 update on peer review of preferential tax regimes

The OECD on 21 June 2023 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 Inclusive Framework on BEPS approved the results on 9 June 2023.

The updated results cover new decisions on five preferential tax regimes. According to the press release, a total of 319 tax regimes were reviewed, or are under review by the Forum on Harmful Tax Practices.

This latest review reflects that three regimes have been abolished (one for Aruba and two for San Marino). Additionally, a regime for Jordan has been amended to align with the standard and is now considered nonharmful, and a regime for Albania is currently in the process of being amended. No regimes are identified as currently under review.

The updated results of the review of preferential tax regimes reflect the continuing focus of the Inclusive Framework on jurisdictions' implementation of the BEPS Action 5 minimum standard. These results will also shape the assessments conducted by the EU Code of Conduct Group, potentially impacting taxpayers through updates to the EU list of non-cooperative jurisdictions. The next update of the EU assessment is scheduled for October 2023.

Miscellaneous

OECD announces 48 jurisdictions to implement CARF by 2027

The OECD on 10 November announced that 48 countries and jurisdictions, including the United States, have pledged to implement the OECD Crypto-Asset Reporting Framework (CARF) by 2027. CARF provides for the automatic exchange of tax information on crypto-assets.

OECD FTA agrees on action to support continued digital transformation, delivering Pillar Two and capacity building

The OECD's Forum on Tax Administration (FTA) held its 16th plenary meeting in Singapore on 11-13 October 2023. The Statement of outcomes: 2023 FTA Plenary Meeting released at the conclusion of the meeting outlined the agreed-upon actions and commitments made by the FTA in three key areas, with the FTA members agreeing to:

- Collaborate on projects to utilize new technology to enable the vision of the FTA's 2020 publication *Tax Administration 3.0: The Digital Transformation of Tax Administration* to be met, through reducing tax gaps and compliance burdens
- Work together on the consistent and effective implementation of Pillar Two and the strengthening of cooperation between tax administrations to provide certainty over administration of global minimum tax rules
- Enhance the effectiveness and reach of its global capacity building efforts through closer partnership with other international and regional organizations

The FTA agreed the projects on Tax Administration 3.0 should begin in December 2023.

OECD Secretary-General Tax Report provides international tax update

In connection with the July 2023 G20 Finance Ministers and Central Bank Governors meeting, the OECD released several documents that cover international tax matters beyond the BEPS 2.0 project, as well as a BEPS update. The OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors provided a review of the ongoing work on Pillars One and Two and indicated that the OECD was continuing to work on economic impact estimates of the Pillar Two global minimum tax and would publish its analysis in the coming months.

In the area of tax and development, the Secretary-General Report references the release of the G20/OECD Roadmap on Developing Countries and International Tax, which provides an update on developments in this area since the 2022 report. This update focuses on developing countries' engagement with respect to both the BEPS 2.0 project and the original BEPS project and on new programs with respect to carbon mitigation approaches and Value-Added Taxes (VAT)/Goods and Services Taxes (GST) on e-commerce.

The Secretary-General Report includes a section on developments with respect to tax transparency, noting recent updates on information reporting with respect to crypto-assets and implementation of effective information exchange practices. Three new documents related to tax transparency prepared at the request of the Indian G20 Presidency are attached to the report:

- A report on Enhancing International Tax Transparency on Real Estate
- An update on Unleashing the Potential of Automatic Exchange of Information for Developing Countries
- A report on Facilitating the Use of Tax-Treaty-Exchanged Information for Non-tax Purposes

OECD releases 2023 report on tax transparency in Latin America

The OECD in late June 2023 published a progress report, "Tax Transparency in Latin America 2023," in connection with the eighth meeting of the Punta del Este Declaration, an initiative established in 2018 and focused on improving effective exchange of information in tax administrations in Latin America.

The report provides an update on the progress achieved to date and describes how jurisdictions in the region have developed and implemented a strategy to increase the use of exchange of information as a tool to support audits and investigations using the international network and the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum).

United Nations

UN releases final report on international tax cooperation

The United Nations (UN) in late August 2023 released a final report (dated 26 July 2023) suggesting alternative options to promote international tax cooperation. The report offers an analysis of the existing arrangements in international cooperation and provides other options to "make such cooperation fully inclusive and more effective and outlines potential next steps."

According to the report, enhancing the UN's role "in tax-norm shaping and rule-setting, with full consideration of existing multilateral and international arrangements, appears the most viable path for making international tax cooperation fully inclusive and more effective." As in an earlier released draft, the final report identifies three options to be considered, including a tax multilateral convention, a framework convention on international tax cooperation, and a framework for international tax cooperation.

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