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Treasury and IRS news

US Treasury official comments on OECD international tax deliberations

A US Treasury official recently discussed the scope of US government involvement and input regarding the ongoing OECD deliberations on international taxation beyond digital. The official's comments were made around the time of the release of a [Policy Note](#) by the OECD on 29 January 2019, which set out an ambitious two-pillar approach that, if implemented, would impact most multinational companies, including those with highly-digitalized business models as well as those relying heavily on intellectual property.

(The Policy Note's two-pillar approach was further developed in a [public consultation document](#) released by the OECD on 13 February 2019. The OECD consultation document is discussed later in this edition of the *Washington Dispatch*.)

OECD Policy Note

The OECD's stated goal, as set out in its Policy Note, is to reach a new consensus-based, long-term solution in 2020 to the tax challenges brought by the digitization of the economy.

The Policy Note states that there is now agreement among the 127 jurisdiction-strong Inclusive Framework on BEPS to examine proposals involving two pillars which could form the basis for consensus. The first pillar addresses the broader challenges of the digitalized economy and focuses on the allocation of taxing rights among countries, including nexus issues. The second pillar addresses remaining BEPS issues. The OECD believes that a two-pillar approach would be effective in recognizing that the digitalization of the economy is pervasive, raises broader issues, and is most evident in, but not limited to, highly digitalized businesses.

The two-pillar approach, according to the Policy Note, raises questions regarding where tax should be paid and in what amount, in a world: "where enterprises can effectively be heavily involved in the economic life of different jurisdictions without any significant physical presence and where new and often intangible value drivers more and more come to the fore."

The Treasury official, speaking at a District of Columbia Bar Association meeting, said that the US government is engaged in the OECD process "out of the very deep concern that the longstanding international consensus around the allocation of taxing jurisdiction is breaking down." This is

highlighted, he said, by the accelerating trend of unilateral actions by various countries over the past five years, including:

- ▶ Diverted profits taxes, some of which were enacted only weeks after the BEPS consensus was secured
- ▶ Various advances by the European Commission in State aid cases
- ▶ Section 59A (Base Erosion and Anti-Abuse Tax (BEAT)) enacted by the 2017 US tax reform, which departs from the arm's-length standard and denies deductions for very real payments and very real economic functions
- ▶ Proposals around both European Union (EU)-wide and unilateral Digital Services Taxes (DST) that are levied on gross revenues, and which have the potential to create double taxation

The US official noted that there is currently broad political dissatisfaction around the world with tax planning outcomes that are possible under the existing international framework, and that the unilateral measures in response are highly politicized. As such, he said, the process is no longer a purely technical exercise. The US government therefore hopes that with increased involvement, a broad political consensus can be built at the OECD level as to how taxing jurisdiction can be allocated between different countries with different taxation models.

US position

According to the official, the US government's position has been to try and move the discussion away from the taxation of narrow business models such as search engines, intermediation platforms and social media platforms toward a broader solution that recognizes the political dissatisfaction with the current international tax paradigm.

He noted that the current dissatisfaction by many governments is not limited solely to the taxation of highly digitalized business models, but also to other businesses that rely equally on intangible assets and intellectual property where, in certain circumstances, the arm's-length standard of transfer pricing is not performing optimally.

France and Germany, it was noted, have used these discussions to push forward one of their priorities, the broad adoption of a minimum tax.

The Treasury official said that there is a common understanding and agreement among jurisdictions that they will have to be pragmatic in order to arrive at any kind of consensus. Additionally, he noted, developing countries have asked for measures that are administrable and reasonably simple, considering their lesser resources for tax administration. He further added that all parties seem to have an honest intention to find a global solution.

According to the official, in order to achieve consensus on the first pillar, it will be important to recognize the importance of marketing intangibles. Here, he suggested that a fairly simple and formulaic approach may be agreeable to many jurisdictions, in effect providing extra allocation of income to market jurisdictions.

Another possible approach (on which it was not clear if it would work on a stand-alone basis or in combination with other measures) may be to give market jurisdictions the right to tax some defined small spread on revenues for distribution activities in their jurisdictions, adjusting this formulaic amount on the profitability of the worldwide business model.

Going forward

The involvement of the US in the public discussion of the tax challenges brought by the digitization of the economy is significant. Collectively, the potential new measures and approaches set out in the OECD's Policy Note and further described by the US official would, if implemented, represent fundamental and significant changes to the current system of cross-border taxation, and may take this debate far beyond digital.

These changes are complicated and interlinked, and in many cases would be likely to require amendments to income tax treaties.

US supports global efforts to adopt corporate minimum tax

US Treasury Secretary Steven Mnuchin said in late February that the US government supports France's efforts to encourage countries to adopt a corporate minimum tax. Several European countries have indicated support for some form of a global minimum tax, taking their cue from the US's enactment of global intangible low-taxed income (GILTI). The Treasury Secretary also reiterated the US government's opposition to unilateral enactment of digital services taxes, including France's proposal.

No plans to loosen anti-corporate inversion regulations

An IRS official in February disclosed there are no plans to ease restrictions included in the final anti-corporate inversion regulations released in July 2018. The official was quoted as saying that Congress could have rolled back the inversion rules when it enacted the *Tax Cuts and Jobs Act*, but declined to do so. The official suggested there remains strong policy concerns regarding corporate inversions.

A minimum tax is one of the proposals in the OECD's public consultation document on possible solutions identified to address issues related to base erosion and profit shifting, in addition to proposals related to tax challenges arising from the digitalization of the economy that was released on 13 February. It is expected to be one of the subjects of discussion at a 13-14 March OECD public consultation in Paris.

A senior Treasury official was also quoted as saying that the multilateral global minimum tax discussions are at the earliest stages, and all design options are on the table, including a per country approach or an average rate approach similar to that in the GILTI provision. The former approach could present significant challenges, the official noted.

US government may miss June 2019 deadline to finalize TCJA international regulations

The US government may not be able to finalize all the proposed international tax regulations by June 2019 as it had originally planned, according to several officials.

A Treasury official was quoted as saying in mid-February that he expected the final global intangible low-taxed income (GILTI) regulations would be released before 22 June, perhaps as early as spring but possibly early summer. The remainder of the proposed international tax regulations would likely be finalized in the order they were released, he said. The official implied that the magnitude of the work needed to finalize those regulations may push some of the final regulations to be released past the June deadline.

Another senior Treasury official was quoted as saying that finalizing the proposed Section 163(j) regulations and the various international tax regulations are the government's top priority, but said it was not clear if the Section 163(j) project would be completed before 22 June 2019.

Final Section 965 regulations clarify filing Form 965-A or 965-B with transfer agreements

The IRS in February published the final Section 965 transition tax regulations in the Federal Register. The final regulations clarified that Form 965-A or 965-B must only be filed with a transfer agreement if the eligible Section 965(h) transferor or eligible Section 965(i) transferor was required to file the form.

Because guidance is lacking, in regard to the due date for transfer agreements to be filed, the transition rules have been updated to provide that if a triggering or acceleration event occurs on or before 5 February 2019, the transfer agreement must be filed by 7 March 2019 in order to be considered timely filed.

IRS LB&I requiring transfer pricing teams to consult with APMA

The IRS Large Business & International Division issued a memorandum (LB&I-04-0219-001) at the end of February that requires transfer pricing issue teams to consult with the Advance Pricing and Mutual Agreement (APMA) office on issues involving transfer pricing transactions between US taxpayers and related parties in US tax treaty countries that may result in adjustments for which competent authority assistance may be required.

The new requirement applies whether or not the taxpayer currently has a mutual agreement procedure (MAP) or advance pricing agreement (APA) case in APMA or whether APMA has an active relationship with the treaty partner.

The IRS also is requesting comments on final regulations ([T.D. 8656](#)) that provide guidance on imposition of the Section 6662 accuracy-related penalty for Section 482 adjustments. Comments are due by 30 April 2019.

OECD news

OECD opens public consultation on addressing tax challenges arising from digitalization of the economy

On 13 February 2019, the OECD issued a public consultation document seeking public comments on possible solutions identified to address the tax challenges arising from the digitalization of the economy.

The publication of the consultation document was discussed in the 29 January 2019 [Policy Note](#) published by the Inclusive Framework on BEPS (BEPS IF), following the agreement by the 128-strong members of the BEPS IF to examine proposals involving two pillars. One pillar would focus on the allocation of taxing rights and a second pillar would address BEPS issues.

Importantly, the consultation document sets out more detail on the proposals within both pillars than was previously known. The consultation document also notes that the impact of these proposals is not limited to digital business models, and would impact any business models utilizing intangible assets.

The OECD notes that the proposals included in the consultation do not represent the consensus views of the BEPS IF, the OECD's Committee on Fiscal Affairs (CFA) or their subsidiary bodies.

The [consultation document](#) describes the proposals discussed by the BEPS IF at a high level, and seeks comments from the public on a number of policy issues and technical aspects. The comments will assist the BEPS IF in preparing a solution for its final report to the G20 leaders in 2020. That final report will be preceded by an update to that group in 2019.

The 32-page consultation document is divided into three key sections:

- ▶ **Section 1: Introduction:** provides detailed background, reviewing the OECD's work in this area to date
- ▶ **Section 2: Revised profit allocation and nexus rules:** provides detailed examination of three key proposals under debate
- ▶ **Section 3: Global anti-base erosion proposal:** sets out proposals to address the continued risk of profit shifting to entities subject to no or very low taxation

The discussion on revising the profit allocation and nexus rules focuses primarily on two proposals: user participation and marketing intangibles. The user participation proposal addresses digital business and the value created by digitalized businesses through “developing an active and engaged user base, and soliciting data and content contributions from them.” That value is most significant in business models such as social media, search engines, and online marketplaces. The proposal seeks to revise profit allocation rules to accommodate such value-creating activities, and to revise nexus rules so that user jurisdictions would have the right to tax the additional profit allocable to them.

A marketing intangibles approach would change the profit allocation and nexus rules for a broader set of businesses (beyond digital) that enter a jurisdiction to develop a user/customer base and other marketing intangibles. The document acknowledges “an intrinsic functional link between marketing intangibles and the market jurisdiction.”

Current transfer pricing and tax treaty rules would have to be modified under the proposal, to require marketing intangibles and risks associated with such intangibles to be allocated to the market jurisdiction, which would be entitled to tax some or all of the associated income. A “significant economic presence” proposal is also discussed.

The consultation paper's second pillar addresses the remaining BEPS challenges of risk and profit shifting to entities that are subject to no or very low taxation, through a global anti-base erosion proposal: this includes two interlocking rules -- an income inclusion or minimum tax, and a tax on base eroding payments. The income inclusion rule would operate as a minimum tax by requiring a shareholder

in a foreign branch or controlled entity to bring into account a proportionate share of income if that income was subject to a low effective tax rate in the jurisdiction, applied on a per jurisdiction basis.

The proposal for a tax on base eroding payments would include both an “undertaxed payments rule” that would deny a deduction for a payment to a related party if the payment was not subject to tax at a minimum rate, and a “subject to tax rule” to deny treaty benefits if the item of income is insufficiently taxed in the other jurisdiction.

OECD releases fifth batch of peer review reports on BEPS Action 14

On 14 February 2019, the OECD released the fifth batch of peer review reports relating to the implementation by Estonia, Greece, Hungary, Iceland, Romania, Slovak Republic, Slovenia, and Turkey of the Base Erosion and Profit Shifting (BEPS) minimum standard on Action 14 (*Making Dispute Resolution Mechanisms More Effective*).

Overall, the reports conclude that the majority of these jurisdictions meet most or almost all of the elements of the Action 14 minimum standard. Iceland meets more than half of the elements of the Action 14 minimum standard, and Romania meets less than half of these elements. In the next stage of the peer review process, each jurisdiction's efforts to address any shortcomings identified in its Stage 1 peer review report will be monitored. The Stage 2 peer review of the fifth batch is scheduled to commence in October 2019.

The OECD is currently working on the Stage 1 peer review reports for the sixth and seventh batch of jurisdictions and the Stage 2 peer review reports for the first batch. The OECD will continue to publish Stage 1 peer review reports in accordance with the Action 14 peer review assessment schedule, and will issue the first Stage 2 peer review reports in the coming months.

OECD releases first annual peer review report on BEPS Action 6

On 14 February 2019, the OECD released the first peer review [report](#) relating to the compliance by members of the Inclusive Framework on Base Erosion and Profit Shifting (IF on BEPS) with the minimum standard on BEPS Action 6 for prevention of treaty abuse. The report covers 116 jurisdictions and includes information available as of 30 June 2018 (cut-off date).

Overall, the report concludes that a large majority of the IF on BEPS members have begun to translate their commitment on treaty shopping into actions and are now in the process of modifying their treaty network. According to the report, the peer review shows the efficiency of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (MLI) in implementing the treaty-related BEPS measures, and it is by far the preferred tool of the IF on BEPS members for implementing the minimum standard.

By the cut-off date, 82 jurisdictions had some agreements that were already compliant with the minimum standard or were subject to a complying instrument. Once the complying instrument (i.e., the MLI or a protocol/treaty) takes effect, the agreements will come into compliance with the minimum standard.

The progress of the jurisdictions assessed will be reflected in peer review reports in subsequent years. The next peer review exercise will be launched in the first half of 2019 and it will also include a review of the new members of the IF on BEPS. The methodology used to conduct the review will be reviewed in 2020.

According to the report, the ultimate aim of the BEPS work on Action 6 is not simply to see anti-treaty shopping provisions inserted into tax treaties, but to put an end to treaty shopping itself. In this respect, the report mentions that the work on Action 11 will help in the monitoring of the impact of the implementation of the minimum standard on treaty shopping and in the interpretation of the aggregate and jurisdictional data in future peer review reports.

Most treaty changes to implement the minimum standard under BEPS Action 6 will be effective from 2020 and any conflicts that may occur from these treaty changes will have to be resolved through Mutual Agreement Procedures.

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