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OECD developments

OECD holds consultation on tax challenges of digitalization with aggressive 2020 timeline for consensus

The OECD on 13-14 March 2019 held its eagerly anticipated public consultation on preliminary proposals for addressing the global tax challenges of digitalization. The groundwork for the meeting was the OECD consultation document, *Addressing the Tax Challenges of the Digitalisation of the Economy*, that was released in February 2019.

OECD officials emphasized that the effort is in the early stages, with plenty of future opportunities for public input. EY submitted a comment letter and a global team of EY representatives participated in the consultation.

The OECD consultation document includes two separate sets of proposals, referred to by OECD officials as pillar one and pillar two. Pillar one involves revised profit allocation and nexus rules aimed at expanding taxing rights of the user or market jurisdiction based on the existence of certain intangible assets, including so-called marketing intangibles. Pillar two involves two integrated global anti-base erosion rules: an income inclusion rule likened to a minimum tax on profits and rules for taxing so-called base-eroding payments (accomplished through the denial of tax deductions or treaty benefits for payments that are not subject to a minimum level of tax).

The OECD received over 200 comment submissions on the consultation document that was issued in February.

During the meeting, dozens of stakeholders urged caution in the development of the details of what potentially are sweeping changes to long-standing rules for determining taxing jurisdiction over business profits and broad new anti-base erosion rules that go well beyond the 2015 Base Erosion and Profit Shifting (BEPS) project recommendations. Many stakeholders also expressed the view that some changes to the international tax system are inevitable to better align the taxing rules with the new global economy. Because the consultation was intended as an opportunity to hear from stakeholders, the government representatives who attended were largely in listen mode and did not share their views during the sessions.

The OECD has adopted an aggressive timeline for attempting to reach consensus on a coordinated global approach by 2020. Grace Perez-Navarro, deputy director of the OECD Centre for Tax Policy and Administration, described a number of steps that will take place between now and 2020. She said the consultation will be followed by a more thorough analysis of the comments, a meeting of the steering group of the Inclusive Framework on BEPS in April, and discussions at the margins of the World Bank / International Monetary Fund spring meetings (12-14 April).

A work program for technical working groups will be developed and presented to the Inclusive Framework at the end of May for approval. The work program will then be presented to G20 Finance Ministers at the beginning of June, and then to G20 leaders at the end of June. Beyond June is when the hard technical work will be carried out with further opportunities for more input.

Treasury and IRS news

IRS issues proposed Section 250 regulations on calculating FDII and GILTI deduction

In early March 2019, Treasury and the IRS issued proposed regulations under Section 250 (REG-104464-18) that provide guidance for calculating the deduction allowed to a domestic corporation for its foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI). The proposed regulations primarily provide guidance for calculating a domestic corporation's FDII; proposed regulations for calculating GILTI were released 13 September 2018.

Section 250 generally allows a domestic corporation a deduction for its FDII and GILTI inclusions for a tax year. For tax years beginning after 31 December 2017, but on or before 31 December 2025, a domestic corporation may claim a deduction equal to 37.5% of its FDII, and 50% of the sum of its GILTI and any Section 78 dividend with respect to GILTI (Section 78 GILTI dividend). For tax years beginning after 31 December 2025, these percentages decrease to 21.875% and 37.5%, respectively.

The proposed regulations provide guidance for determining the components of a domestic corporation's FDII calculation – namely, deduction eligible income (DEI), deemed tangible income return (DTIR), deemed intangible income (DII) and foreign-derived deduction-eligible income (FDDEI). Detailed rules are further provided to determine the sub-components of certain components.

Guidance is also provided to coordinate the calculation of the allowed Section 250 deduction with the application of other limitations in the Code (Sections 163(j) and 172(a)) that are based on a domestic corporation's taxable income for a tax year. Finally, special rules are provided for individuals that make a Section 962 election for a tax year, consolidated groups, and tax-exempt corporations.

The proposed regulations restate and confirm much of what is in Section 250. More importantly, however, they provide helpful guidance for many open questions not addressed clearly by the statute, the most critical of which is how to determine foreign use. In this regard, the proposed regulations require extensive documentation to prove foreign use, which is perhaps simply a compliance exercise, although obtaining documentation could be difficult in business-to-consumer transactions.

The proposed regulations under Section 250 would apply to tax years ending on or after 4 March 2019. For tax years before that date, the proposed regulations provide that taxpayers may use any reasonable documentation maintained in the ordinary course of business, provided the documentation meets the reliability requirements.

The proposed regulations under Section 962 would apply to a foreign corporation's last tax year ending on or after 4 March 2019 and to the tax year of the domestic person in which or with which such tax year of the foreign corporation ends.

The proposed regulations under Section 1502 would apply to consolidated return years ending on or after the date of publication of the Treasury decision adopting the rules as final regulations in the Federal Register. Taxpayers may, however, rely on Prop. Reg. Section 1.1502-50 before that date.

Final GILTI regulations coming by summer, proposed PTI regs late summer / early fall

A US Treasury official in March said that the final global intangible low-tax income (GILTI) regulations will be released by this summer and the loss stock basis adjustment rules in the proposed Section 951A regulations will be part of a further "round 2" project. He was quoted as saying that the delay should not be interpreted as meaning the government is stepping back from the original proposal rules, noting the rationale behind the loss stock basis adjustment rules remains intact. The official added that when those rules are finalized, they will be prospective.

Another Treasury official was quoted as saying that proposed previously taxed income (PTI) regulations will be released in late summer or early fall, a delay from previous indications the regulations would be released this spring.

Treasury and the IRS last December released Notice 2019-01, announcing that the government intended to issue regulations addressing certain issues arising from the *Tax Cuts and Jobs Act* with respect to foreign corporations with previously taxed earnings and profits (PTEP). The notice described regulations that Treasury intended to issue, including: (i) rules relating to the maintenance of PTEP in annual accounts and within certain groups; (ii) rules relating to the ordering of PTEP upon distribution and reclassification; and (iii) rules relating to the adjustment required when an income inclusion exceeds the earnings and profits of a foreign corporation.

It was anticipated that the regulations announced in the notice would apply to taxable years of US shareholders ending after the date of release of the notice and to taxable years of foreign corporations ending with or within such taxable years. In addition, the Notice provides that taxpayers may rely on the regulations for certain earlier periods (including the Section 965 transition year) if they and certain related persons apply the rules consistently.

IRS releases final FATCA regulations covering compliance and verification procedures

The IRS issued final *Foreign Account Tax Compliance Act* (FATCA) regulations (TD 9852) under Chapter 4 (Sections 1471 through 1474) on 21 March 2019 that provide compliance requirements and verification procedures for: (1) sponsoring entities of foreign financial institutions (FFIs); (2) certain non-financial foreign entities (NFFEs); (3) trustees of certain trustee-documented trusts; (4) registered deemed-compliant FFIs; and (5) financial institutions that implement consolidated compliance programs (compliance FIs). The regulations are effective 25 March 2019.

Among other things, to follow industry practice, the final regulations expand the definition of the term "responsible person" with respect to a sponsoring entity to include "an officer of an entity that establishes and maintains policies and procedures for, and has general oversight over, the sponsoring entity, provided such individual has sufficient authority to fulfill the duties of a responsible officer."

The final rules also provide that a sponsorship agreement is not required "to be a standalone agreement, and that a sponsorship agreement between a sponsoring entity and a sponsored FFI can refer generally to the obligations of the parties under FATCA."

The preamble to the regulations enforces the 31 March 2019 due date for the sponsoring entity certifications of compliance. Sponsoring entities should review the sponsored entities that are subject to the certification requirements (which include sponsored entities located in Model 2 or non-intergovernmental agreement jurisdictions and may also include some entities located in Model 1 jurisdictions) and confirm they have performed a review of compliance to make the certification.

EU comments on Section 59A BEAT provision

The European Union (EU) has commented to Treasury and the IRS on the proposed regulations under the Section 59A Base Erosion and Anti-abuse Tax (BEAT). The European Commission wrote that although they support the BEAT objective to reduce tax avoidance and aggressive tax planning, the proposed regulations "introduce trade distortions or discrimination that would appear to be incompatible with World Trade Organization (WTO) rules and other international commitments taken by the US."

More specifically, the Commission contends that the BEAT is "discriminatory in a manner that is inconsistent with the … WTO requirement of national treatment in trade in services because it would in effect only apply to outbound payments to foreign related companies, and would not apply to comparable payments to US related companies."

Section 59A, enacted by the *Tax Cuts and Jobs Act*, is currently under review by the OECD Forum on Harmful Tax Practices, which has indicated it will not issue any decisions until the related final regulations are released.

Transfer pricing news

IRS APMA releases Functional Cost Diagnostic Model to be used in certain APAs

On 26 February 2019, the IRS Advance Pricing and Mutual Agreement Program (APMA) released an excel-based financial model that APMA intends to use when reviewing certain Advance Pricing Agreement (APA) requests. The stated purpose of the model is to allow the IRS "to better understand the controlled taxpayers' contributions to the proposed covered transactions, including the respective contributions each controlled taxpayer makes to the exercise of control over the economically significant risks surrounding the proposed covered transactions."

To that end, the Functional Cost Diagnostic Model (FCD Model) collects, identifies, organizes and analyzes the costs incurred by each controlled taxpayer related to the covered transactions. It then computes a pro forma profit (loss) split. APMA will compare the pro forma profit split results to the results achieved under the transfer pricing method proposed in a taxpayer's APA request.

APMA assured taxpayers that it will use the FCD Model in limited circumstances, only for diagnostic purposes, and its application does not imply that the residual profit split is necessarily the "most appropriate method" under the OECD Guidelines for the covered transactions.

Although APMA stated it intends to use the FCD Model in a manner consistent with the revised OECD Guidelines for both inbound and outbound cases, stressing concepts such as important functions and control, it is not clear how this relates to concepts and principles already embedded in the Section 482 regulations. For example, it is unclear how the FCD Model will relate to principles such as respecting contractual arrangements (including allocation of risks) that have substance, and the appropriate return to risky financing of investments.

The FCD Model approach is another example of pressures on transfer pricing policies in which risks are separated from functions. If a taxpayer's covered transactions involve more than routine functions and risks, the IRS will ask the taxpayer to complete this model to see if the residual profit split method or another method is more appropriate than the taxpayer's proposed method to provide arm's-length results. This will involve more due diligence on the part of taxpayers,

IRS updates FATCA FAQs

The IRS in March updated FATCA frequently asked question (FAQ) FAQ Q23, extending penalty relief for the 2018 calendar year under certain circumstances. It also published new FAQ Q24, addressing the 2018 tax year withholding and reporting requirements for certain partnerships and trusts.

including a viewpoint toward system-wide profit that may not be readily available. While the results of the FCD Model could substantially agree with the results of the taxpayer's original method results, the analysis will have to be completed to make that determination.

IRS requiring transfer pricing teams to consult with APMA in certain cases

The IRS Large Business & International Division issued a memorandum (LB&I-04-0219-001) in early March 2019 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 is also requesting comments on final regulations (TD 8656) that provide guidance on imposition of the Section 6662 accuracy-related penalty for Section 482 adjustments. The comments are due by 30 April 2019.

IRS releases 2018 APA results

The IRS in Announcement 2019-3 released a report in late March on the US advance pricing agreement (APA) program covering the 2018 calendar year. A total of 107 bilateral APAs were executed in 2018, with Japan (39%) and Canada (20%) representing the largest number of countries. There were 203 APA applications filed in 2018, with Japan (34%) and India (21%) representing the largest number. Although most of the transactions covered in APAs executed in 2018 involved the sale of tangible goods or the provision of services, over 20% involved the use of intangible property. The median time for completion of an APA in 2018 was 40.2 months, up from 33.8 months in 2017.

OECD releases beneficial ownership toolkit

The OECD on 20 March 2019 released a new beneficial ownership toolkit, the purpose of which is to help governments implement the *Global Forum on Transparency and Exchange of Information for Tax Purposes* standards. The toolkit is meant to ensure that tax administrations have access to reliable information on a company's or other legal entity's ultimate beneficial owners. The toolkit is particularly aimed at developing countries.

Puerto Rico update

Puerto Rico's Treasury Department issues guidance for mandatory electronic filing of CIT returns for 2018 tax year

The Puerto Rico Treasury Department (PRTD) has issued guidance (Circular Letter (CL) 19-08) for the electronic filing of corporate income tax returns for tax year 2018.

As background, domestic and foreign corporations that are engaged in a trade or business in Puerto Rico generally must file a corporate income tax return no later than the 15th day of the fourth month following the close of the tax year. For tax year 2018, the corporate income tax return for calendar-year taxpayers must be filed no later than 15 April 2019; and for fiscal-year taxpayers, by no later than the

US, India sign CbC exchange agreement

The US and India signed an agreement for the exchange of country-by-country (CbC) reports on 27 March 2019, according to an Indian government announcement. The new agreement will enable both countries to exchange CbC reports filed by ultimate parent entities of international groups in the respective jurisdictions, for financial years beginning on or after 1 January 2016. Therefore Indian constituent entities of US headquartered international groups that have already filed CbC reports in the United States would not be required to file CbC reports locally in India.

15th day of the fourth month following the close of the tax year. Foreign corporations that do not have an office or place of business in Puerto Rico must file their corporate income tax returns no later than the 15th day of the sixth month following the close of the tax year.

For tax year 2018, corporations and limited liability companies taxed as corporations will be required to electronically file their Puerto Rico corporate income tax returns (Form 480.20) through a program certified by the PRTD. Certified programs can be accessed on the PRTD's website under Corporate Returns 2018 under the "Hacienda Virtual" link.

Tax return specialists using a private program to prepare the corporate income tax returns for their corporate clients may also use the private program to electronically file these returns. To complete the electronic filing, the tax specialists must be registered with the PRTD and use their social security number or employer identification number and the password provided by the PRTD through email.

The PRTD will not consider a return timely filed if a taxpayer fails to comply with the mandatory electronic filing requirement. Corporations and limited liability companies that file Puerto Rico corporate income tax returns should take notice of the changes so they comply with their filing obligations.

Other corporations (e.g., exempt businesses under the Puerto Rico Incentives Programs filing Form 480.30II, and life insurance companies filing Form 480.40D or Form 480.40F) and conduit entities (e.g., partnerships, LLCs with election or statutorily required to be partnerships) will continue to file their income tax returns on paper.

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