Report on recent US international tax developments – 12 July 2019

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The United States (US) Government upped the ante on France's pending digital tax legislation this week when President Trump instructed US Trade Representative (USTR) Robert Lighthizer to initiate an investigation, under Section 301 of the *Trade Act of 1974*, of France's new Digital Services Tax (DST). The Office of the USTR announced it will hold a public hearing on the French DST on 19 August. The tax was approved by the French Senate on 11 July, a week after it was passed by the lower house, the National Assembly. French President Emmanuel Macron is expected to sign the legislation. An adverse finding by the USTR could lay the groundwork for the US taking retaliatory action against France.

The French DST legislation will impose a retroactive 3% tax on total annual revenues generated by some companies from providing certain digital services to, or aimed at, French users. The US Government's position is that the French DST, as well as other similar unilateral measures under consideration, are disproportionately aimed at US multinational companies. In a 10 July statement, Lighthizer said: "The President has directed that we investigate the effects of this legislation and determine whether it is discriminatory or unreasonable and burdens or restricts United States commerce."

US government officials have repeatedly indicated the US prefers a multilateral solution to address the cross-border tax issues associated with the digitalization of the economy. Bipartisan members of Congress have also expressed serious concern to Treasury over proposed unilateral digital tax measures. A recent letter by Senate Finance Committee Chairman Chuck Grassley and ranking member Ron Wyden to Treasury Secretary Steven Mnuchin urged the Administration to "consider all available tools under US law to address such targeted, discriminatory taxation," including the imposition of Section 891. That provision allows for the doubling of rates of tax on citizens and corporations of certain foreign countries if the President finds that US citizens or corporations are being subjected to discriminatory or extraterritorial taxes.

In an 11 July letter to the Senators, Treasury indicated that "without action by the U.S. government, other countries will adopt taxes similar to the French DST." The letter went on to say that the Administration is "evaluating a range of potential U.S. responses to the adoption of a French DST."

Also on 11 July, US Senate Majority Leader Mitch McConnell announced that the Senate will proceed to consideration of protocols amending tax treaties with Spain, Switzerland, Japan, and Luxembourg (in that order), early next week. The four tax protocols were approved by the Senate Foreign Relations Committee on 25 June 2019. The pending agreements have been awaiting action in the Senate for nearly a decade and held up over Senator Rand Paul's information sharing concerns. Senator Paul has said he will not permit "abbreviated" consideration of the protocols in the full Senate, meaning the chamber will need to overcome certain procedural hurdles prior to a vote on ratification (which requires a two-thirds majority of Senators present and voting). Senate leaders hope to complete consideration of all four protocols next week.

In its meeting on 25 June, the Foreign Relations Committee did not consider the new US tax treaties with Chile, Hungary, and Poland, which may require reservations to account for enactment of the Base Erosion and Anti-abuse Tax (BEAT) by the 2017 *Tax Cuts and Jobs Act*. The four tax protocols set for Senate votes next week are narrower in scope and unaffected by the BEAT, so no reservations were required for them.

The US Treasury and the Internal Revenue Service (IRS) on 10 July released proposed regulations (REG-105474-18) on passive foreign investment companies under Internal Revenue Code[1] Sections 1291, 1297 and 1298. The proposed regulations contain significant guidance on various foundational issues and computational matters. Among the many areas covered by the proposed rules, the regulations apply the corporate attribution rules "top-down" when a partnership indirectly holds a foreign corporation being tested for passive foreign investment company (PFIC) status (Tested Foreign Corporation) through another corporation that is not a PFIC. The proposed regulations also address certain computational and character issues that arise in applying the income and asset tests of Section 1297(a), such as which exceptions under subpart F from passive income treatment are relevant for PFIC-testing purposes, how to apply the tests to partnership interests held by the Tested Foreign Corporation, and how to treat stapled entities.

The proposed regulations further provide guidance regarding when a foreign corporation is a qualifying insurance corporation (QIC) under Section 1297(f) and the amounts of income and assets that a QIC excludes from passive income and assets under the Section 1297(b)(2)(B) – the PFIC insurance exception -- for purposes of Section 1297(a).

The proposed regulations would apply to taxable years of US persons that are shareholders in certain foreign corporations beginning on or after the date of publication of the rules as final regulations. Until finalization, taxpayers may apply the proposed regulations (with certain exceptions) in their entirety to all open tax years as if they were final regulations provided they are consistently applied.

Endnote

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

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