

Report on recent US international tax developments - 11 October 2019

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The Organisation for Economic Co-operation and Development (OECD) on 9 October 2019 released a public consultation document outlining a proposal from the OECD Secretariat for a ["Unified Approach" under Pillar One](#) of the ongoing project titled "Addressing the Tax Challenges of the Digitalisation of the Economy." The proposal, which does not represent a consensus view by countries in the Inclusive Framework on Base Erosion and Profit Shifting (BEPS), provides high-level suggestions on the scope of the new rules being developed under Pillar One. The scope of the proposal for a "unified approach" covers highly digitalized business models and also non-digitalized businesses that are consumer-facing.

The consultation document includes both a new nexus concept as well as new and revised profit allocation rules. The new nexus concept is not dependent on physical presence and is largely based on sales. This new nexus is proposed to be separate from the existing permanent establishment concept and would operate regardless of whether taxpayers have an in-country marketing or distribution presence or sell through related or unrelated distributors.

The consultation document also provides a three-part approach to new and revised profit allocation rules. They would provide a formulaic approach to allocating deemed non-routine profits to market jurisdictions under the new nexus concept, a formulaic approach for a fixed return to baseline marketing and distribution activities in situations where there is nexus under existing principles, and an approach for allocating additional profit to the market jurisdiction where the local activities exceed such baseline activity.

The proposals are intended to facilitate negotiations among the countries, with the aim of achieving a political agreement among the Inclusive Framework jurisdictions by the first half of 2020.

Comments on the consultation document must be submitted no later than 12 November 2019. The OECD will hold a consultation meeting in Paris on 21 and 22 November 2019.

The consultation document does not address the Pillar Two work on development of new global minimum tax rules. The OECD Secretariat has indicated that a consultation document on this topic will be released in November 2019, with a consultation meeting to be held in December 2019.¹

An EY webcast on 31 October titled “OECD BEPS 2.0 is coming: how do you navigate cross-border business in the wake of change?” will examine OECD developments in addressing the tax challenges of the digital economy, including the recent Pillar 1 proposal. To register, link [here](#).

On 11 October, the United States (US) Treasury and the Internal Revenue Service (IRS) released Notice 2019-58, which relates to the final, temporary, and proposed Internal Revenue Code² Section 385 regulations that were issued in October 2016. Those regulations include Reg. Section 1.385-3, which treats certain debt instruments as equity if they are issued in certain types of related-party transactions. The temporary and proposed regulations issued under Reg. Sections 1.385-3T and -4T contain, among other things, important guidance for the qualified short-term debt exception and debt instruments issued between members of a consolidated group.

Under Section 7805(e), Reg. Sections 1.385-3T and -4T will expire on 13 October 2019. In light of the imminent expiration, the Notice allows taxpayers to rely on the identical proposed regulations (which do not expire) for periods following the expiration of the temporary regulations until further guidance is issued, provided that the taxpayer consistently applies all the rules contained in the proposed regulations.

The Notice does not make any changes to the general rules of Reg. Section 1.385-3.

Separately, a submission relating to Section 385 was made to the Office of Management and Budget (OMB) Office of Information and Regulatory Affairs (OIRA) on 8 October. It is unclear at this time what aspect of Section 385 the submission addresses.

The IRS this week issued guidance on the tax treatment of cryptocurrency transactions in the form of Frequently Asked Questions (FAQs) and a revenue ruling. In 43 [FAQs](#), the IRS expands on its 2014 cryptocurrency guidance in [Notice 2014-21](#) by providing more examples of: (i) when taxpayers recognize gain or loss on an exchange of cryptocurrency; (ii) how to calculate basis in cryptocurrency; and (iii) when taxpayers recognize income on other cryptocurrency-related transactions. Notice 2014-21, the IRS’s first formal guidance in this area, explained the Service’s position that virtual currency is treated as property for federal income tax purposes and offered examples of how existing tax principles that apply to property transactions applied to virtual currency.

In [Revenue Ruling 2019-24](#), the IRS ruled that a “hard fork” (e.g., when one cryptocurrency becomes two) will not cause taxpayers to recognize income under Section 61. Taxpayers will recognize income, however, if they receive new units of cryptocurrency (i.e., an “airdrop”) following the hard fork. The revenue ruling has no effective date.

At the time of publication of this Alert, several international tax regulation packages are listed as pending review at OIRA. Final *Tax Cuts and Jobs Act* foreign tax credit regulations and proposed regulations described as “Follow-on Guidance Related to the Foreign Tax Credit, Including Guidance Implementing Changes Made by the *Tax Cuts and Jobs Act* [TCJA]” are listed as under OIRA review, having been received on 3 October.

Final Section 59A Base Erosion and Anti-abuse Tax (BEAT) regulations and a new package of proposed BEAT regulations also remain under OIRA review, having been received 16 September.

Endnotes

- 1 See EY Global Tax Alert, [The OECD takes next step on BEPS 2.0 - Proposal for a “unified approach” for additional market country tax](#), dated 10 October 2019.
- 2 All “Section” references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

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