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Legislation

US Senate Majority Leader, Sen. Manchin reach agreement on $740b budget reconciliation bill with 15% corporate minimum tax

During a tumultuous month during which the possibility of a Democratic budget reconciliation bill seemed to be fading away, Senate Majority Leader Chuck Schumer (D-NY), Senator Joe Manchin (D-WV) and President Biden on 27 July announced a deal on a $740 billion reconciliation bill that includes climate/energy, health and tax components and achieves $300 billion in deficit reduction. There are no international tax provisions in the bill.

The announcement followed Senator Manchin apparently backing away from talks over a broader bill two weeks prior, citing high US inflation.

Senator Manchin earlier in the month said he took global intangible low-taxed income (GILTI) changes that would bring the measure in line with the BEPS 2.0 Pillar Two 15% minimum tax off the table during the negotiations.

The final bill, titled the *Inflation Reduction Act of 2022*, would fund climate and energy provisions and a 3-year extension of enhanced *Affordable Care Act* (ACA) subsidies with a 15% corporate alternative minimum tax on adjusted financial statement income for corporations with profits over $1 billion, increased IRS enforcement funding, a carried interest holding period for capital gains treatment of 5 years (up from 3), and Medicare drug negotiation. The 15% corporate minimum tax would be effective for tax years beginning after 31 December 2022.

As of the end of the month, the legislative text had been submitted to the Parliamentarian for budget reconciliation review and Senate Democrats hoped to take up the bill before the start of the August recess.

House Speaker Nancy Pelosi (D-CA) announced support for the proposal and the expectation is that the House, which left Washington for the August recess, will reconvene to approve a Senate-passed bill.

US Congress passes Creating Helpful Incentives to Produce Semiconductors (CHIPS) bill with investment tax credits and incentives

The Senate (on 27 July) and the House (28 July) passed the *CHIPS and Science Act* (HR 4346), a $280 billion bill that aims to build a domestic US supply chain for semiconductor chips in the face of foreign competition, while also spending billions on scientific and technological research to keep US industries competitive with China. As the month closed, the bill went to the President for signature.

The legislation includes $52.7 billion in funding for semiconductor manufacturing subsidies, grants, and loans. The bill includes a 25% investment tax credit for investments in semiconductor manufacturing and incentives for manufacturing of specialized tooling equipment required in the semiconductor manufacturing process, with taxpayers allowed to treat the credit as a payment against tax (direct pay).

IRS news

Treasury and IRS publish technical corrections to final foreign tax credit regulations

The US Treasury on 27 July 2022 published technical corrections (87 FR 45018) to controversial final regulations (T.D. 9959) on foreign tax credits published on 4 January 2022.

The technical corrections revise the cost recovery requirement, which is a key element of the final regulations' rules for determining the creditability of a foreign tax under Section 901. The technical corrections also revise rules for allocating and apportioning foreign taxes paid or accrued with respect to certain sales of property that are disregarded for US federal tax purposes and limit the foreign taxes taken into account under the global intangible low-taxed income (GILTI) high-tax exclusion. The technical corrections represent the first round of changes to the final regulations, with additional changes expected in the coming months.

The technical corrections include limited revisions to rules coordinating the interaction of the final regulations with income tax treaties, although they did not change one of the more controversial aspects of the treaty coordination rule. The final regulations provided that if the relief from the double taxation article of an income tax treaty entitles a citizen or resident of the United States to claim a credit with respect to a foreign tax, then that citizen or resident may claim the credit even though the foreign tax would not otherwise be creditable under the final regulations. Because CFCs are not considered residents under US tax treaties, the implication – which many taxpayers dispute, but which was not addressed in the technical corrections – is that income tax treaties do not provide for a deemed paid credit under Section 960 for foreign taxes paid by a CFC.)

The technical corrections' applicability dates mirror those of the relevant underlying final regulations. As a result, the technical corrections to the cost recovery rules apply to foreign income taxes paid or accrued in tax years beginning on or after 28 December 2021. The technical corrections to the disregarded sales rules apply to tax years that begin after 31 December 2019 and end on or after 2 November 2020. Finally, the technical corrections to the GILTI high-tax exclusion affect tax years beginning on or after 28 December 2021.

US government officials have indicated that the government intends to provide additional guidance relating to the final regulations. That guidance may include proposed regulations addressing other aspects of the net gain requirement, such as the attribution requirement.

Under the final regulations, for example, many countries' withholding taxes imposed on royalties may not be creditable, despite the fact that they have traditionally been creditable and are consistent with widely accepted international tax norms. Proposed regulations are expected to provide additional exceptions to the attribution requirement that would make those taxes creditable, although the scope and effectiveness of those exceptions will remain uncertain until any guidance is issued.

Government officials have also indicated that they continue to consider whether further guidance is warranted under the disregarded payment rules. Those rules allocate and apportion foreign income taxes imposed on remittances by reference to the tax book value of the payor tested unit's assets, which leads to frequent distortions when the assets of the tested unit are assigned to one statutory grouping (for example, cash or bank deposits assigned to the passive category) but the income of the tested unit arises in another category (for example, general category tested income).

IRS proposed regulations would limit Section 1256 mark-to-market accounting for foreign currency contracts to foreign currency forward contracts

Treasury and the IRS on 5 July 2022 issued proposed regulations under Section 1256 (REG-130675-17). The proposed regulations would expressly overrule the Sixth Circuit's decision in *Wright v. Commissioner*, 809 F.3d 877 (6th Cir. 7 Jan. 2016) to limit the term "foreign currency contract" to only certain foreign currency forward contracts, and not foreign currency options.

The Preamble states that the proposed regulations do not change the status of foreign currency options that otherwise qualify as Section 1256 contracts. Specifically, nonequity options are separately listed as Section 1256 contracts in Section 1256(b)(1)(C). Section 1256(g)(3) defines a nonequity option as any listed option that is not an equity option. Section 1256(g)(5) defines a listed option as "any option … traded on (or subject to the rules of) a qualified board or exchange." Therefore, a foreign currency option that is listed on a qualified board or exchange is a "nonequity option" and remains subject to Section 1256.

The proposed regulations would be generally effective for contracts entered into on or after the date that is 30 days after their publication as final regulations in the Federal Register.

Taxpayers that have relied on *Wright* to include foreign currency options in the definition of foreign currency contracts will need to consider whether they intend to early adopt the proposed regulations or await final regulations mandating a transition. In particular, taxpayers should consider any potential system changes and book-tax differences, as well as whether a change in accounting method is necessary and, if so, whether that change is automatic or non-automatic.

Taxpayers that have not relied on the *Wright* decision ought to continue to exclude their over-the-counter foreign currency option contracts from the definition of foreign currency contracts under Section 1256. All taxpayers, regardless of jurisdiction, should continue to treat listed foreign currency options as non-equity options subject to Section 1256.

As the proposed regulations do not define the term "forward contract," and the Preamble indicates that the IRS may apply existing anti-abuse rules and judicial doctrines in determining the proper characterization of a transaction, taxpayers should reexamine their transactions to determine whether they are properly characterized as forward contracts or foreign currency options.

Tax treaties

US Treasury announces termination of tax treaty with Hungary

The US Treasury officially announced that the US Government on 8 July 2022 notified Hungary that it was terminating the US-Hungary tax treaty. According to the announcement, the treaty termination will be effective on 8 January 2023. According to the termination provisions contained in the treaty, the treaty will cease to have effect with regard to withholding tax on 1 January 2024, and with respect to taxable periods beginning on or after 1 January 2024.

Various media sources quoted a Treasury spokesperson in July as saying there have been "long-held concerns" with Hungary's tax system referring, for example, to a reduction in the Hungarian corporate tax rate to 9%. Some media outlets suggested that Hungary's current opposition to the proposed 15% global minimum tax proposal in BEPS 2.0 Pillar Two may have also played a role.

A Treasury spokesperson was quoted as saying that "Hungary made the U.S. government's long-standing concerns with the 1979 tax treaty worse by blocking the EU directive to implement a global minimum tax," and that "if Hungary implemented a global minimum tax, this treaty would be less one-sided; refusing to do so could exacerbate Hungary's status as a treaty-shopping jurisdiction, further disadvantaging the United States."

A new tax treaty with Hungary was negotiated and signed in 2010 though it never entered into force. It remains to be seen whether further negotiations could take place impacting the status of treaty relations between the two countries. However, if the six-month notice period continues to run without any revocation of the notice, the existing treaty would generally cease to have effect in 2024.

OECD developments

OECD releases Progress Report on Amount A of Pillar One of BEPS 2.0 project

The OECD Secretariat on 11 July 2022 released a *Progress Report on Amount A of Pillar One* (the Progress Report) in connection with the ongoing OECD/G20 project on *Addressing the Tax Challenges Arising from the Digitalisation of the Economy*. "Amount A" refers to a new taxing right over a portion of the profit of large, high-revenue enterprises for countries where their goods or services are supplied, or countries where their consumers are located.

The Progress Report is a consultation document that covers many of the building blocks with respect to Amount A and is presented in the form of domestic model rules. The Progress Report does not yet include the rules on the administration of the new taxing right, including the tax certainty-related provisions.

Together with the Progress Report, the OECD released a Cover Note by the OECD/G20 Inclusive Framework on BEPS providing a revised schedule for the work on Amount A. The OECD also released a Frequently Asked Questions document on Amount A and a Fact Sheet providing an overview of the structure of the Amount A rules. In addition, the OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors (G20 Tax Report) for their 15-16 July 2022 meeting was released at the same time.

The Progress Report and the accompanying Cover Note provide significant new information with respect to the possible design of Pillar One Amount A and reflect a new timeline for its planned implementation.

The documents make clear that the Amount A rules will not come into force in 2023 as had been reflected in the timeline agreed by the Inclusive Framework in October 2021. The Inclusive Framework is seeking written comments from stakeholders on the overall design of the Amount A rules reflected in the Progress Report by 19 August 2022, with plans to review the input received and seek to stabilize the rules at its October 2022 meeting.

When the Amount A rules are stabilized, they will be translated into provisions for inclusion in a Multilateral Convention (MLC), to be signed and ratified by Inclusive Framework members. The agreed schedule reflects the expectation that this work will be completed so that a signing ceremony for the MLC can be held in the first half of 2023, with the objective of enabling it to enter into force in 2024 once a critical mass of jurisdictions has ratified it.

Next steps

As noted earlier, the public consultation on the Progress Report is open for stakeholder input until 19 August 2022 and all written comments received will be made publicly available. Following this, the Inclusive Framework will meet in October 2022 with the aim of stabilizing the rules. The Cover Note states that a signing ceremony of the MLC for the implementation of Amount A is expected to be held in 2023 with the objective of enabling it to enter into force in 2024 upon ratification by a critical mass of countries.

The Cover Note also indicates that good progress is being made on the work on Amount B, with the expectation that Amount B will be delivered by year-end.

G20 Finance Ministers reiterate commitment to BEPS 2.0 two-pillar implementation and call for action to finalize work

On 15-16 July 2022, the G20 Ministers of Finance and Governors of Central Banks met in Bali, Indonesia. The G20 Chair's summary issued at the conclusion of the meeting includes a reiteration of the G20 Finance Ministers' ongoing commitment to implement the agreement on the G20/OECD BEPS 2.0 two-pillar international tax package.

The summary includes a call for action to finalize Pillar One, including by signing the Multilateral Convention in the first half of 2023, and to complete the negotiations that would allow the development of the Multilateral Instrument for implementation of the Subject to Tax Rule under Pillar Two. The summary was issued by the G20 Chair and it is not a joint statement.

In advance of the meeting, the OECD released the OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors, providing an overview of the latest international tax developments, including updates on Pillars One and Two.

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