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US Congress

Kevin McCarthy new House Speaker, Rep. Smith chairs Ways and Means Committee

Representative Kevin McCarthy (R-CA) became the new Speaker of the House of Representatives on 7 January 2023, reaching the necessary majority vote on the 15th ballot. Days later, the House GOP Steering Committee elected Representative Jason Smith (R-MO) to be the new chairman of the Ways and Means Committee.

In a statement, Representative Smith listed out his priorities, which included examining whether to "continue showering tax benefits on corporations that have shed their American identity" and using trade and tax policy to "re-shore and strengthen our supply chains, where products and services vital to our national security are made here at home using American labor," among others.

The press also reported that President Biden requested that Treasury Secretary Janet Yellen stay on in her post and that she accepted. The Treasury Secretary is expected to continue implementing provisions of the *Inflation Reduction Act* and to move forward with the BEPS 2.0 agenda.

JCT will release 'Blue Book' by end of June

The congressional Joint Committee on Taxation (JCT) will issue a "Blue Book" (a general explanation of major tax reform acts) in the first half of 2023 on four pieces of tax legislation that were enacted by the 117th Congress, according to the JCT chief of staff in January.

The Blue Book reportedly will cover provisions enacted by the *Inflation Reduction Act* – which includes the new corporate alternative minimum tax and stock buyback excise tax – the *American Rescue Plan Act of 2021*, the *CHIPS and Science Act of 2022*, and the *Infrastructure Investment and Jobs Act*. The coming Blue Book will also cover the *Consolidated Appropriations Act, 2023*, which was enacted on 29 December 2022, as well as certain technical corrections. According to the tax press, the Blue Book likely will be released by the end of June 2023.

Treasury and IRS news

Final regulations issued for qualified foreign pension funds contain some favorable clarifications

Treasury and the IRS published final regulations (T.D. 9971) on 29 December 2022 that address the qualification for the exemption from taxation under Section 897(l) for gain or loss attributable to the disposition of US real property interests (USRPIs) held by qualified foreign pension funds (QFPFs) and their wholly owned subsidiaries. The final regulations also address gain from distributions described in Section 897(h), as well as related withholding requirements under Sections 1445 and 1446.

Section 897 treats gain recognized by a foreign person from the disposition of a USRPI as income that is effectively connected with a US trade or business, and therefore, is subject to net basis tax at the graduated, regular US federal income tax rates. In 2015, Congress amended Section 897 to create a new exemption under Section 897(l) for USRPIs held by QFPFs or an entity wholly owned by a QFPF.

The final regulations retain the general approach of the proposed regulations that were published on 6 June 2019, with few substantive changes, but some helpful clarifications.

The final regulations generally apply to dispositions of USRPIs and distributions described in Section 897(h) occurring on or after 29 December 2022, although certain provisions apply to distributions of USRPIs described in Section 897(h) occurring on or after 6 June 2019. An eligible fund may choose to apply the final regulations to dispositions and distributions occurring on or after 18 December 2015 and before 29 December 2022, provided that it applies the rules consistently for all relevant years.

IRS proposed regulations would make major changes to domestically controlled QIE rules under Section 897, and certain controlled commercial entity rules under Section 892

The IRS published proposed regulations (REG-100442-22) on 29 December 2022 that address whether qualified investment entities (QIEs), which include real estate investment trusts (REITs), are considered domestically controlled for purposes of the *Foreign Investment in Real Property Tax Act* (FIRPTA) rules of Section 897.

In a move that is bound to create significant controversy, the proposed regulations would apply a look-through approach to certain US C corporations to determine whether foreign persons directly or indirectly hold a QIE's stock. In particular, look-through treatment would apply to a privately held domestic C corporation if "foreign persons" (as defined in the proposed regulations) own, directly or indirectly, 25% or more of the fair market value of its stock.

The proposed regulations also address the treatment of qualified foreign pension funds (QFPFs) and qualified controlled entities (QCEs) in determining whether a QIE is domestically controlled. The proposed regulations would treat QFPFs and QCEs as foreign persons for this purpose. This is the case even though QFPFs and QCEs are not subject to the Section 897(a) FIRPTA tax under Section 897(l), which led some to argue QFPFs and QCEs should be treated similarly to domestic tax-exempt persons, which the proposed regulations would treat as domestic persons for purposes of these rules, rather than foreign persons.

The proposed regulations would only be effective for dispositions of QIE stock occurring after the date final regulations are issued. According to the preamble, however, the IRS may challenge positions contrary to the proposed regulations before the final regulations are issued.

Further, and perhaps more concerning, the proposed regulations would apply to determine whether a QIE has been domestically controlled throughout the entire testing period (generally five years) before the sale of its stock, even for the portion of the testing period that occurs before the regulations' finalization. This approach, if adopted, could severely limit a QIE's ability to proactively cure, before the effective date, any failure of domestically controlled status that the proposed regulations would create.

The practical implications of the domestically controlled QIE provisions of these proposed regulations, if finalized in their current form, would be very broad and very significant for investment structures that involve domestically controlled REITs with taxable foreign owners.

Even measuring their potential impact could require considerable time and effort, e.g., reviewing side letters where fund sponsors have agreed to structure a REIT as domestically controlled, determining who the ultimate owners of a foreign-owned domestic corporation would be, determining what 25% of the FMV of a domestic corporation would be at any given time during a testing period whose starting point is not yet known, or determining whether restructuring is desirable in light of the proposed rules.

The proposed regulations also address the treatment of QFPFs and QCEs for purposes of the US tax exemption for income of foreign governments under Section 892.

The proposed regulations would change the Section 892 regulations so that a foreign corporation that is a QFPF or a QCE and also a US real property holding corporation (USRPHC) would not be treated as engaged in commercial activities and could thus qualify for the Section 892 exemption, if other relevant criteria were satisfied. A similar rule would apply to a foreign corporation that is controlled by a foreign government and would be a USRPHC solely because it owns direct or indirect interests in other corporations that are not controlled by the foreign government.

The proposed regulations were published concurrently with final regulations on qualifications for QFPFs and QCEs under Section 897(l) and related withholding provisions. (See article above.)

US-Hungary treaty termination effective 8 January 2023

On 8 July 2022, Treasury officially began the process of terminating the US-Hungary Tax Treaty (signed in 1979). According to the Treasury Press Release, termination of the treaty is effective on 8 January 2023, and with respect to taxes withheld at source, the convention shall cease to have effect on 1 January 2024. On 27 December 2022, the text of a joint statement between the US and Hungary was posted on the IRS Country-by-Country (CbC) Reporting Jurisdiction Status Table.

The Statement acknowledges that the 2018 Agreement on Exchange of Country-by-Country Reports is expected to terminate on 8 January 2023 and provides that the US and Hungary are in the process of negotiating an intergovernmental agreement and competent authority arrangement to allow for the automatic exchange of CbC Reports. Prior to entry into force of these agreements, the Statement outlines agreements reached with respect to exchange of CbC Reports for fiscal years commencing 1 January 2021.

OECD announces new tax policy head

The OECD on 13 January announced that former US Treasury official Manal Corwin will become director of the Centre for Tax Policy and Administration (CTPA), replacing Grace Perez-Navarro who will retire on 31 March. Perez-Navarro, who was the deputy director of the CTPA, became the director after long-time head Pascal Saint-Amans left the position in October 2022.

IRS addresses deductions involving cryptocurrency in two CCA memos

The IRS released two, non-taxpayer specific Chief Counsel Advice memoranda (CCAs) in January 2022 involving cryptocurrency transactions, both concluding that cryptocurrency is not a "security" under Section 165(g)(2).

In CCA 202302011, the IRS determined that a taxpayer could not claim a loss deduction for cryptocurrency that had lost almost all its value; in CCA 202302012, the IRS determined that a taxpayer could not claim a charitable deduction for a donation of cryptocurrency that had not been independently appraised.

Worth noting, the overwhelming majority of CCAs that are released are taxpayer specific and involve post-filing issues (i.e., issues on which field examiners need assistance from the national office.) These two "non-taxpayer specific advice" CCAs are outliers in that regard.

Acting IRS Commissioner affirms continued participation in ICAP

Douglas O'Donnell, the IRS Acting Commissioner, told a December conference in Washington that while the International Compliance Assurance Program (ICAP) could be improved, the IRS will continue to participate in the program. ICAP was created by the OECD to provide taxpayers greater tax certainty on international tax issues. The IRS has continuously participated in ICAP since 2018, the year it was rolled out as a pilot program.

Taxpayers may voluntarily enter ICAP, which facilitates co-operative engagements between multinationals and tax authorities in their local jurisdictions. ICAP allows multinationals to present their tax position to several tax administrations simultaneously in a more cooperative environment than a typical audit. Although a taxpayer cannot receive legal certainty that its tax positions will be accepted through ICAP, the program can reduce the likelihood the taxpayer will be audited and allows the taxpayer to develop relationships with multiple tax administrations.

ICAP is likely to continue to be modified in the future as the OECD, the IRS and other tax administrations gain more experience with the program. While ICAP may not be right for every multinational taxpayer, it can provide greater and cost-effective tax certainty, particularly if the IRS begins to limit, as has been suggested, the number and types of Advance Pricing Agreement applications to be accepted in the future.

Transfer pricing

IRS examiners must consult IRS Counsel before applying economic substance doctrine in transfer pricing audits

An IRS official in mid-January 2023 told an American Bar Association Section of Taxation meeting that examiners still must consult with IRS Counsel before asserting related penalties related to the economic substance doctrine (ESD).

The statement by the Large Business and International (LB&I) Division Counsel follows an IRS decision to no longer require IRS examiners to obtain executive-level approval in order to assert the ESD under Section 7701(o) during an audit.

IRS temporarily relieves foreign financial institutions from reporting US TINs for certain accounts, provided various requirements are satisfied

The IRS has provided temporary relief (Notice 2023-11, released 30 December 2022) to certain foreign financial institutions from the requirement to report US Taxpayer Identification Numbers (TINs) for certain accounts in existence before the effective dates of FATCA and associated Intergovernmental Agreements.

The ESD assesses whether: (i) a transaction impacts a taxpayer's economic position beyond the federal income tax effects; and (ii) the taxpayer had a substantial business purpose for entering into the transaction other than for federal income tax purposes. If a transfer pricing position lacks economic substance, the IRS, in addition to proposing audit adjustments, may assert Section 6662(i) penalties of up to 40%.

After guidance released in April 2022, examiners no longer have to obtain executive-level review. Instead, the official was quoted as saying "[i]nitial review and coordination of the potential assertion of the doctrine begins with field counsel advising examiners." The review "extends up the chain of command through … herself and is coordinated with the associate chief counsel for procedure and administration and briefed to the deputy chief counsel of operations."

Taxpayers should consider the ESD when planning their intercompany transactions and create contemporaneous supporting documentation. Taxpayers should also continue to focus on penalty protection measures, including transfer pricing documentation.

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