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Legislation

Congress passes debt ceiling bill, averts possible default

The US House (314-117) and Senate (63-36) in late May 2023 passed the *Fiscal Responsibility Act of 2023* (H.R. 3746), a debt ceiling bill agreed to by President Biden and House Speaker Kevin McCarthy (R-CA). President Biden signed the legislation into law on 1 June.

The deal came just days before the 5 June deadline that Treasury Secretary Janet Yellen cited as the potential date the US could default on its debt. The legislation suspends the statutory debt ceiling through 1 January 2025, along with applying curbs on government spending and clawbacks of IRS and COVID-19-related funding.

The Act rescinds $1.4 billion of the *Inflation Reduction Act's* $80 billion in increased IRS funding. The press also has reported that the package includes a separate agreement that will reallocate $20 billion from the $80 billion in IRS funding to other nondefense spending.

According to the Congressional Budget Office, the bill would reduce deficits by $1.5 trillion over the 2023-2033 period relative to May 2023 baseline projections under caps to discretionary funding provisions in the legislation.

US House Ways & Means Republicans introduce tax increase on foreign companies to influence global tax deal

US House Ways and Means Committee Chairman Jason Smith (R-MO), joined by every Republican on the Committee, on 25 May introduced legislation aimed at discouraging countries from adopting a key component of Pillar Two, the Undertaxed Profits Rule (UTPR).

The *Defending American Jobs and Investment Act* focuses on the potential impact on US multinational corporations that have an effective tax rate of less than 15%, within the meaning of Pillar Two, on their US profits because they've availed themselves of US tax incentives. The legislation would increase taxes on the US businesses of companies headquartered in countries that enact the UTPR, but it would also apply in the context of other taxes imposed on US businesses if those taxes meet a set of criteria deeming them to be either extraterritorial or discriminatory in nature.

The proposed legislation would add new IRC Section 899 to cause rates specified in particular Code sections (e.g., Section 871(a)) to accelerate by 5% until the additional rate reaches 20% (an annual increase) when a foreign country enacts one or more extraterritorial taxes or discriminatory taxes. The text of the bill is available here.

Under the new section, the Secretary will be required to submit a report 90 days after enactment and at least every 180 days thereafter. The report will identify the country, describe the tax, and the rate of tax being imposed by the foreign jurisdiction. Then, the Secretary "shall commence enhanced bilateral engagement" with each listed country to express concern, urge repeal, and advise of remedial actions.

Chairman Smith said: "As the exclusive trade and tax-writing committee in the House of Representatives, the Ways and Means Committee has a variety of tools that can be deployed to stop bad actors that try to harm American workers and businesses. We remain prepared to invoke additional tax and trade countermeasures, should these attempts to undermine our tax sovereignty continue," said Chairman Smith.

US Senate Finance Committee holds Rx, international tax hearing

The Senate Finance Committee (SFC) on 11 May 2023 held a hearing on "Cross-border Rx: Pharmaceutical Manufacturers and U.S. International Tax Policy." Democratic members and some witnesses criticized perceived profit shifting by the pharmaceutical industry even after enactment of the 2017 *Tax Cuts and Jobs Act's* guardrails, while Republican members expressed concern about the effect of the OECD-led Pillar Two global minimum tax on US multinational corporations, particularly the undertaxed profits rule (UTPR) and treatment of US tax credits including the R&D tax credit.

In effect, it was the tale of two hearings. The SFC Democratic majority released a report ahead of the hearing finding that large pharmaceutical companies report a collective 75% of taxable income in foreign subsidiaries, including for some drugs that are household names in the US. Republicans, meanwhile, used the hearing to focus on Pillar Two and the UTPR.

It is unlikely that this legislation will be enacted in this Congress as it would require bipartisan support and the support of the Biden administration. Committee Republicans instead hope the introduction of the bill will encourage the OECD and the Inclusive Framework participants in Pillar Two to reconsider introduction of UTPRs in their own domestic legislation.

A number of countries are in the process of enacting both the Income Inclusion Rule and the Qualified Domestic Minimum Top-up Tax for effect in 2024 but have put off enactment of the UTPR as many countries have agreed it should not take effect until 2025 at the earliest.

Treasury and IRS news

IRS proposed regulations would turn off Section 367(d) following certain IP repatriations

Treasury and the IRS released proposed regulations (REG-124064-19; Proposed Regulations) on 2 May 2023, that would apply new rules to "repatriations" of intangible property (IP) subject to Section 367(d). In certain circumstances, the Proposed Regulations would permit the annual inclusions that Section 367(d) and its regulations require to cease. The Proposed Regulations would be effective only for IP repatriations occurring on or after the date on which the final regulations are published.

Following certain nontaxable transfers of IP to a foreign corporation, a US transferor generally must include in income annually amounts that are (1) contingent upon productivity, use and disposition of the IP; and (2) commensurate with the income that the transferee foreign corporation earns from the IP (outbounded IP) during its useful life.

The Proposed Regulations would modify the subsequent transfer rules to terminate continuing annual inclusions if two conditions are met:

- The transferee foreign corporation (TFC) repatriated the outbounded IP to a "qualified domestic person"
- The original US transferor complied with certain reporting requirements

The form of the IP repatriation, including the recognition of gain or loss, would not affect the applicability of the termination rule.

The Proposed Regulations would also address certain ancillary consequences of an IP repatriation (whether or not the termination rule applies). They include:

- The amount of gain required to be recognized by a US transferor
- The basis that the QDP takes in the repatriated IP
- Adjustments to the E&P of the TFC

The coming implementation of the BEPS 2.0 Pillar Two GloBE Rules, as approved by the OECD Inclusive Framework, is causing many companies to re-evaluate their operating models for owning and using IP. With the US corporate tax rate at a globally competitive 21% and the potential for lower effective tax rates under Section 250, many US companies have an incentive to simplify their operating models by repatriating IP. Uncertainty around the consequences of repatriating outbounded IP subject to Section 367(d) complicates any re-evaluation of operating models in light of global developments.

The termination rule would be a taxpayer-favorable rule removing a significant disincentive to repatriating previously outbounded IP. Taxpayers that have previously considered repatriating IP that is subject to annual inclusions under Section 367(d) have encountered ambiguity and possible "excessive taxation" caused by the current regulations.

While the Proposed Regulations are not "reliance regulations," and therefore may only be applied if finalized, taxpayers with outbounded IP should start re-evaluating IP operating models in light of BEPS and the Proposed Regulations. Taxpayers considering whether to repatriate IP subject to Section 367(d) are encouraged to consider whether the termination rule would present a repatriation opportunity that simplifies the operating model and aligns IP ownership with the functions and employees associated with the IP.

IRS addresses taxation of digital currency

The IRS has reaffirmed (Notice 2023-34) its consistent position since 2014 that digital currency is not currency for US tax purposes, and advised that a change in the underlying protocol of a blockchain did not result in a taxable event for a holder of digital assets hosted on that blockchain (Chief Counsel Advice memorandum 202316008).

Notice 2023-34: cryptocurrency as legal tender

In response to some countries' adoption of cryptocurrency as legal tender, Notice 2023-34 updated prior guidance (Notice 2014-21) saying cryptocurrency was not legal tender in "any jurisdiction." Under Notice 2014-21, cryptocurrency is generally considered "virtual currency" and treated as property. Thus, tax principles for property transactions, rather than currency transactions, apply to transactions involving cryptocurrency.

The modification in Notice 2023-34 does not change the IRS's view that "convertible virtual currency" is not a currency and cannot generate foreign currency gain or loss for US federal tax purposes. The IRS explained that the change to Notice 2014-21 does not affect the answers to the frequently asked questions (FAQs) in Section 4 of the Notice, specifically noting Q&A-2, which concludes that convertible virtual currency is not treated as currency that could generate foreign currency gain or loss for US federal tax purposes.

Taxpayers may have inferred from Notice 2014-21 that a digital currency would be treated as currency for US tax purposes if it became accepted as legal tender in another jurisdiction. The modification clarifies that another jurisdiction's adoption of a digital currency as legal tender for a "limited purpose" does not render that digital currency a "currency" for US federal income tax purposes.

CCA 202316008: change in blockchain protocol

In CCA memorandum 202316008, the IRS concluded that a cryptocurrency owner did not have taxable income when the native blockchain of that cryptocurrency underwent a protocol upgrade with no change to the owner's cryptocurrency.

The IRS memorandum does not label the cryptocurrency being discussed; given that Ethereum recently completed the "Merge," a highly publicized transition to the proof-of-stake consensus mechanism, in September 2022, the CCA may be addressing a taxpayer who held Ethereum tokens during the Merge.

CCA 202316008 is helpful in providing guidance on the factors that a taxpayer should consider when determining whether a particular event involving a blockchain protocol results in a realization event.

US officials comment on CAMT

US government officials recently offered insights on several pressing topics at the American Bar Association's Section of Taxation meeting in May 2023. Commenting on the new corporate alternative minimum tax (CAMT), an IRS official said that there will be at least one more notice; there had been speculation whether taxpayers would next see proposed regulations or additional interim guidance. The official was quoted as saying the notice will address depreciation issues and the situation where the tax and financial accounting rules on dispositions diverge.

In regard to other CAMT issues that have cropped up, including in regard to consolidated groups, IRS officials suggested that taxpayers "do what's reasonable" during the period in which the government develops further guidance. An IRS official indicated the agency is currently working on proposed rules that would address treating a consolidated group as a single entity for purposes of the CAMT, as noted in Notice 2023-7. Another official highlighted the fact that Notice 2023-7 calls for single-entity treatment for status computations and computations of CAMT tax liability, adding "It does not say for all [CAMT] purposes."

The expected Joint Committee on Taxation's (JCT) Technical Explanation (Blue Book) to the *Inflation Reduction Act*, which enacted the CAMT, is not likely to provide many answers in regard to the provision, according to a senior Senate Finance Committee staffer. The official said the Blue Book will not provide much insight into the new tax given the broad legislative text and the expansive grant of regulatory authority. The official was quoted as saying that both the corporate AMT and the stock buyback excise tax provisions were relatively clear and likely will not require much in terms of technical corrections. Earlier this year, the JCT Chief of Staff was quoted as saying the Blue Book would be out before the end of June.

IRS GLAM concludes FIRPTA regularly-traded-stock-exception test under Section 897(c)(3) applies at partnership level

The IRS Office of the Chief Counsel recently released a generic legal advice memorandum (AM 2023-003 or GLAM) that addressed the application of the regularly traded stock exception under Section 897(c)(3) to stock of a United States real property holding corporation (USRPHC) held by a partnership.

Section 897(a)(1) was enacted as part of the *Foreign Investment in Real Property Tax Act of 1980* (FIRPTA). FIRPTA takes into account any gain or loss of a nonresident alien individual or foreign corporation from the disposition of a United States real property interest) as if the taxpayer were engaged in a US trade or business and the gain or loss were income effectively connected with that trade or business. The foreign owner must also file a US federal income tax return.

The IRS concluded that the 5% ownership test (10% for real estate investment trusts (REITs)) should apply at the partnership level (an entity approach). Before the GLAM, it was unclear whether the IRS viewed the regularly-traded-stock-exception test to apply at the partner or partnership level.

A GLAM cannot be cited as precedent and merely reflects the position of IRS counsel. Nevertheless, taxpayers that invest in regularly traded USRPHCs through partnerships should consider this GLAM's impact on their current and past positions, especially those for which application of the regularly-traded-stock-exception test at the partnership level would yield a different result than the taxpayer has historically taken.

Nonresident partners should also be mindful of partner-to-partnership attribution under Section 318, which may cause the partnership's interest to exceed the 5% threshold under the regularly-traded-stock-exception test.

Senate Foreign Relations Committee reports out proposed US-Chile tax treaty

The Senate Foreign Relations Committee on 1 June voted out of committee (20-1) the proposed US-Chile tax treaty. The approved agreement includes two reservations and a declaration. Text of the resolution of advice and consent to ratification can be found here. Senate Majority Leader Chuck Schumer (D-NY) earlier said ratification of the treaty was crucial for access to critical minerals such as lithium.

Tax treaties

US negotiating tax agreements with Israel, Switzerland and Norway

US and Israeli tax treaty negotiations are moving in the direction of a new tax treaty, rather than a protocol to the existing treaty, according to a Treasury official quoted in May. The current US-Israel tax convention was signed in 1973 and amended in 1980 and 1993, and does not reflect current US tax treaty policy, the official said.

Tax treaty negotiations with Switzerland are ongoing, according to the official, and are expected to result in a new protocol, rather than a new treaty. Productive negotiations have been progressing over recent months although several issues reportedly remain outstanding.

The Norwegian government also is reporting that it is in negotiations with the United States regarding a new income tax treaty. A new treaty would replace the existing 1971 convention, amended by a 1980 protocol.

Congress considers US-Taiwan tax relationship

A bipartisan group of US House members introduced a resolution on 25 May 2023 calling for legislation to prevent double taxation between the US and Taiwan, with the goal of providing treaty-like benefits through the tax code. The resolution follows the Senate introduction of the *Taiwan Tax Agreement Act of 2023*, which would authorize the Biden Administration to negotiate a tax agreement with Taiwan.

OECD developments

BEPS Pillar One to follow revised implementation plan

The BEPS 2.0 Pillar One project is expected to follow a revised, three-step implementation program, according to Manal Corwin, the new director of the OECD Centre for Tax Policy and Administration, who addressed a 12 May tax conference in Washington, DC.

According to the OECD official, if there is agreement on the Multilateral Convention (MLC) text by the Inclusive Framework, the target will be to release it by the end of July. The second step will be an internal country process to determine whether domestic legislation along with the MLC is necessary and to determine politically whether the country can sign on to the convention. Step three, the OECD director said, is actual ratification by countries. Corwin also indicated there will be consideration of whether Model Rules should accompany the MLC text once it is shared.

Corwin, a former US Treasury official, suggested that 40 countries have indicated their intent to adopt Pillar Two through their own domestic legislation and praised the collaborative process with stakeholders that has influenced the drafting of the rules. No specific technical issues or other implementation issues were discussed, but it is understood that the OECD continues to work through priorities for additional implementation guidance and some additional rules could be released by late summer, with another set of new guidance to follow by year-end.

This next set of guidance will likely cover the rules for the qualified domestic minimum top-up tax safe harbor and how transferable tax credits, like those enacted as part of the *Inflation Reduction Act*, will be treated for purposes of the Model Rules.

Corwin added that other tax projects before the OECD include addressing rules to minimize compliance costs and recommendations on the increasing mobility of workers, crypto assets, and carbon mitigation.

G7 Finance Ministers welcomed OECD progress report on tax cooperation, reiterated commitment to Pillars One and Two implementation

The OECD on 11 May 2023 published a Progress Report (the Report) for the G7 Finance Ministers and Central Bank Governors' May 2023 meeting, which follows up on the OECD's May 2022 report by outlining progress on tax cooperation and identifying potential new areas for future consideration.

The Report describes how the principles set out in the 2022 report are being incorporated into the design of Pillars One and Two under the so-called BEPS 2.0 project and how these principles are being translated into action. It also discusses capacity-building developments and plans.

The G7 Finance Ministers and Central Bank Governors met in Japan on 11-13 May 2023. After the meeting, the G7 Presidency issued a communiqué summarizing key topics discussed. Concerning international taxation, the Finance Ministers reaffirmed their strong political commitment toward the swift global implementation of Pillars One and Two.

The communiqué acknowledged the significant progress in the negotiation of the Pillar One Multilateral Convention (MLC) and reaffirmed the Finance Ministers' commitment to swift completion of the negotiations so that the MLC is ready for signature within the agreed timeline. The communiqué welcomed the progress in implementing Pillar Two into domestic legislation and calls on the Inclusive Framework to work on further administrative guidance for globally consistent implementation.

The communiqué also indicated their intention to support developing countries in strengthening their tax capacity to build sustainable tax revenue sources and highlights the importance of assistance for the implementation of Pillars One and Two.

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