Quarterly tax developments

Things to know about this quarter's tax developments and related US GAAP accounting implications

September 2023

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EY

Building a better working world

Welcome to our September 2023 Quarterly tax developments *publication.*

Here we describe certain tax developments previously summarized in Tax Alerts or other EY publications or identified by EY tax professionals or EY foreign member firms. These developments may affect your tax provision or estimated annual effective tax rate.

We compile this information because we recognize that, for many companies, the most challenging aspect of accounting for income taxes is identifying changes in tax law and other events when they occur so the accounting can be reflected in the appropriate period. However, this publication is not a comprehensive list of all changes in tax law and other events that may affect income tax accounting.

This edition covers certain enacted and effective tax legislation, as well as regulatory developments, legislative proposals and other items identified through 15 September 2023, except as noted.

*We list EY publications that you can access through our **Tax News Update website**, if you are registered. Anyone interested in registering should contact Amy Herlihy at **amy.herlihy@ey.com***

*See our **previous editions** for additional tax developments.*

Tax developments

Legislation enacted in the third quarter

Companies are required to account for the effects of tax law changes on their deferred tax assets and liabilities in the period the legislation is enacted. Similarly, companies must reflect the effects of an enacted change in tax laws or rates in their annual effective tax rate computation in the period the changes are enacted. If an interim change is significant, temporary differences may need to be estimated as of the enactment.

Federal, state and territories

California — On 10 July 2023, California temporarily broadened eligibility for its tax credit for hiring qualified full-time employees to include taxpayers engaged in semiconductor manufacturing, semiconductor research and development (R&D), electric airplane manufacturing, lithium production and the manufacture of lithium batteries. The law does not, however, require these taxpayers' employees to work in a designated census tract or economic development area for the taxpayer to claim the credit. The changes apply for tax years beginning on or after 1 January 2023 and before 1 January 2026. See the **State and Local Tax Weekly for 21 July 2023 and 28 July 2023**.

New Jersey — On 3 July 2023, New Jersey enacted legislation treating global intangible low-taxed income (GILTI) as dividend income that is eligible for the dividend received exclusion. The law also requires the GILTI deduction under Section 250 of the Internal Revenue Code (IRC) to be added back to entire net income.

Other changes include:

- Allowing a current-year deduction for expenses incurred during the same privilege period (i.e., tax year) for which a taxpayer claims a New Jersey R&D credit (retroactively effective for tax years beginning on or after 1 January 2022)
- Repealing the add-back requirement for interest and royalty payments made to an affiliated party, which allows companies to deduct intercompany interest expense and royalties without having to determine whether an add-back exception applies
- Increasing the dividends-received exclusion for dividends received from an 80%-or-greater-owned subsidiary to 100% (from 95%), with a corresponding expense deduction disallowance of 5% of the excluded dividend
- Requiring the dividends-received exclusion to be determined before deducting net operating loss (NOL) carryforwards
- Limiting usage of an NOL to 80% of taxable income in accordance with IRC Section 172
- Allowing combined group members to share NOL and prior NOL (PNOL) carryforwards, regardless of whether a combined filing with the sharing members created the carryforwards
- Requiring combined filers to include receipts from all group members when apportioning income to New Jersey, regardless of whether a member has New Jersey nexus (i.e., the *Finnigan* method)
- Requiring combined filers to include real estate investment trusts (REITs), regulated investment companies (RICs) and investment companies (ICs) that are regarded as "captive" in their combined filing as regular corporations but disallowing all federal deductions and exclusions specific to those REITs, RICs and ICs
- Adopting the *Wayfair* nexus standard for corporate business tax purposes (i.e., nexus exists if a company has New Jersey-source receipts exceeding $100,000 or 200 or more separate New Jersey customer transactions)

- Establishing worldwide filing to require inclusion of income from all sources (e.g., income is not limited to US effectively connected income and can include treaty-protected income) (retroactively effective for tax years ending on or after 31 July 2022)
- Limiting income and expenses included in water's-edge and affiliated group filings (retroactively effective for tax years ending on or after 31 July 2022)
- Generally requiring taxpayers to compute the IRC Section 163(j) interest deduction limitation on a federal consolidated basis, which includes federal consolidated filing affiliates not included in a New Jersey return (retroactively effective for tax years beginning after 31 December 2017) (taxpayers must recompute the limitation with the inclusion of the additional affiliates when the New Jersey return includes all federal consolidated filing affiliates and other affiliates not included in the federal consolidation)

Unless otherwise indicated, the changes are effective for tax years ending on or after 31 July 2023. See **Tax Alert 2023-1182**, dated 5 July 2023.

New Hampshire — On 28 July 2023, New Hampshire enacted legislation decoupling from IRC Section 163(j) for gross business profits tax purposes. Taxpayers may also deduct previously disallowed interest expense equally over three years. These changes are effective for tax years beginning on or after 1 January 2024. See the **State and Local Tax Weekly for 4 August 2023 and 11 August 2023**.

Oregon — On 18 July 2023, Oregon enacted a temporary R&D tax credit for eligible taxpayers in the semiconductor industry. The new credit is based on the federal research credit and equals 15% of the "excess amount" of qualified research activity performed in Oregon by a qualified semiconductor company in support of a trade or business directly related to semiconductors. The credit cannot exceed $4 million per taxpayer and is effective for tax years beginning on or after 1 January 2024 and before 1 January 2030. Unused credits may be carried forward up to five years. See the **State and Local Tax Weekly for 21 July 2023 and 28 July 2023**.

Wisconsin — On 5 July 2023, Wisconsin enacted legislation increasing the refundable portion of its research credit to 25% from 15%. The change applies to tax years beginning after 31 December 2023. See the **State and Local Tax Weekly for 21 July 2023 and 28 July 2023**.

IRC conformity

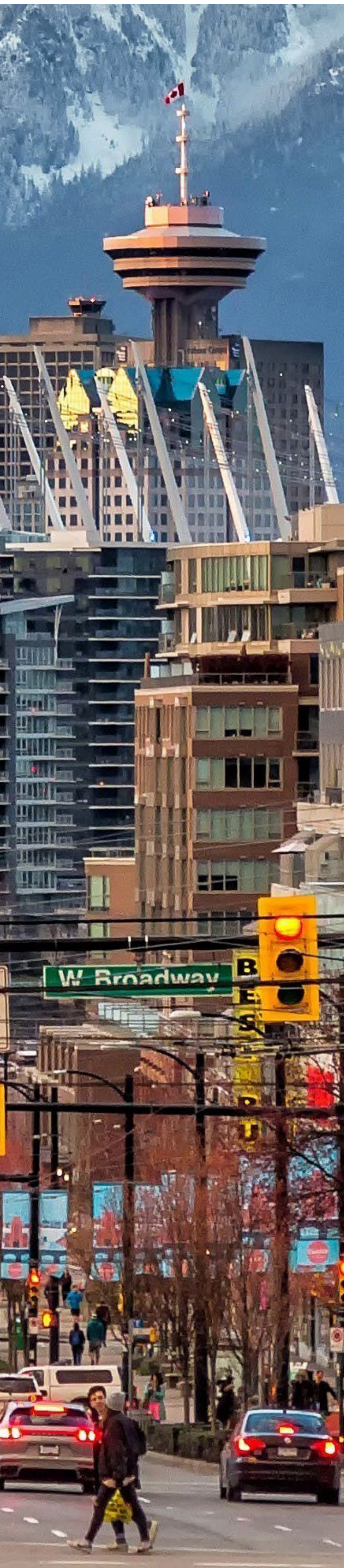
The following chart lists the states that enacted legislation this quarter updating their date of conformity to the US IRC. The chart also includes the dates on which the new conformity date was enacted and became effective. Further information on a state's IRC conformity can be found in the cited reference.

State	Enactment date	Date of conformity	Effective date	Reference
Maine	11 July 2023	31 December 2022	Tax years beginning on or after 1 January 2022	**State and Local Tax Weekly for 21 July 2023 and 28 July 2023**

International

Egypt — On 25 July 2023, Egypt enacted legislation broadening the special incentives available to foreign investors under Investment Law No. 72 of 2017 to include a 35% to 55% refund of taxes on income from a new eligible investment project or an expanded project. The law also permits petroleum manufacturers, iron and steel manufacturers, fertilizer industries, energy-intensive industries, and natural gas liquefiers and transporters to establish projects in the free zones system. Other changes include extending the period during which foreign investors may claim the special incentives, provided certain conditions are satisfied. The changes are effective 26 July 2023. See **Tax Alert 2023-1404**, dated 15 August 2023.

Hong Kong — On 14 July 2023, Hong Kong enacted legislation requiring Hong Kong insurers to adopt a new risk-based capital (RBC) adequacy regime that aligns with international regulatory requirements. The insurers may, however, spread tax liabilities from their required adoption of the regime over five years for certain businesses. The new law also requires non-life long-term insurers to use the "adjusted surplus method," rather than the "formulaic method," to calculate their tax basis. When applying the



"adjusted surplus method" to ascertain assessable profits for an insurance fund that covers both a life insurance business and a non-life long-term insurance business, non-life long-term insurers must apportion the net asset value of the fund based on the premiums that relate to each business. The changes are effective for the tax year in which an insurer adopts the RBC regime, which could be as early as the year ending 31 December 2022, for early adopters on a calendar year-end. See **Tax Alert 2023-1260**, dated 18 July 2023.

Israel — On 31 July 2023, Israel enacted legislation with temporary tax incentives designed to encourage investments and acquisitions of certain high-tech companies. The incentives include:

- Five-year tax amortization for the net acquisition cost of an Israeli high-tech company
- Five-year tax amortization for the net acquisition cost of a foreign high-tech company, subject to specific criteria
- Exemption from withholding tax on interest that Israeli high-tech companies pay to foreign financial institutions resident in countries with which Israel has concluded an income tax treaty

The changes are effective from 31 July 2023 through 31 December 2026. See **Tax Alert 2023-1370**, dated 7 August 2023.

Turkey — On 15 July 2023, Turkey enacted legislation increasing the standard corporate income tax rate to 25% from 20%. The corporate income tax rate for income from financial institutions (e.g., banks, asset management companies, insurance companies) increased to 30% from 25%. Other changes include:

- Maintaining a 20% standard corporate income tax rate for export-related income
- Abolishing the current corporate income tax exemption for investment fund earnings (excluding venture capital funds)
- Modifying the 50% capital gains tax exemption for gains from post-enactment sales of immoveable property held more than two years so that a 25% exemption applies to gains from property purchased before the law's enactment and no exemption applies to gains from property purchased after the law's enactment

The changes were effective upon enactment. See **Tax Alert 2023-1266**, dated 18 July 2023

United Kingdom — On 11 July 2023, the United Kingdom (UK) enacted legislation implementing the global minimum tax rules under Pillar Two of the Base Erosion and Profit Shifting (BEPS) 2.0 initiative of the Organisation for Economic Co-operation and Development (OECD). The legislation includes a qualified domestic minimum top-up tax (QDMTT) and an income inclusion rule (IIR). Both taxes apply to UK entities whose revenues exceed €750 million in at least two of the previous four accounting periods and to UK entities that are part of a group whose revenues exceed €750 million in at least two of the previous four accounting periods. The taxes are effective for accounting periods beginning on or after 31 December 2023.

Other changes include:

- Allowing immediate capital expensing for the next three years for firms investing more than £1 million a year on plants and machinery (effective for qualifying new plant and machinery purchased from 1 April 2023 until 31 March 2026)
- Adding data licenses and cloud computing costs to the categories of expenditures eligible for R&D tax relief (effective for accounting periods beginning on or after 1 April 2023)
- Delaying, by one year, a restriction on including overseas expenditures for externally provided workers among expenses eligible for R&D tax relief, to 1 April 2024
- Increasing the investment rate allowance in the Energy Profits levy to 80% from 29% for qualifying expenses incurred after 1 January 2023, on decarbonizing oil and gas production

See **Tax Alert 2023-1243**, dated 14 July 2023.

Legislation effective in the third quarter

Federal, state and territories

International

Kenya — Effective 1 July 2023, certain companies may carry foreign-exchange losses forward for five years, and capital gains tax applies to gains from sales of shares or comparable interests (e.g., interests in a partnership) if the shares or comparable interests derived more than 20% of their value directly or indirectly from immovable property situated in Kenya in the year before the sale. Capital gains tax also applies to gains from the disposal of shares in a Kenyan company if the shares' owner directly or indirectly held at least 20% of the Kenyan company's capital in the year preceding the shares' disposal.

Other changes include:

- A 15% tax on income repatriated from branches or a permanent establishment (PE)
- A 5% withholding tax on sales promotion, marketing and advertising services
- New income tax exemptions for certain royalties, interest payments, investment income, services income and gains
- A broader definition of immoveable property

The changes were enacted 26 June 2023. See **Tax Alert 2023-1274**, dated 20 July 2023.

Effective 1 September 2023, a 3% tax applies to income from the transfer or exchange of digital assets, which include cryptocurrencies and non-fungible tokens, among others. The change was enacted 26 June 2023. See **Tax Alert 2023-1274**, dated 20 July 2023.

Pakistan — Effective 1 July 2023, the definition of a PE includes a virtual business presence in Pakistan, such as a business conducting transactions through the internet or any other electronic medium, regardless of whether a physical presence exists. Additionally, a PE is no longer required to have a "fixed" place, so a temporary place of business can now create a PE. Other changes to the definition include expanding the scope of the provision on service-based PEs to include services rendered by an "entity" in Pakistan. The changes were enacted on 26 June 2023. See **Tax Alert 2023-1229**, dated 13 July 2023.

Tanzania — Effective 1 July 2023, income tax no longer applies on capital investment leading to company ownership changes because (1) new shares were issued or (2) shares in the resident company were transferred to another resident person. Other changes include:

- Applying a 2% withholding tax to sales of certain precious metals, gemstones or other precious stones by the holder of a primary mining license
- Applying a 10% withholding tax on payments to residents for verified carbon emission reductions
- Exempting a mining company's gains from an internal restructuring to form a partnership with the government from income tax
- Applying normal income tax rules (rather than the presumptive tax regime) to entities engaged in the business of transporting passengers and goods

The changes were enacted 30 June 2023. See **Tax Alert 2023-1225**, dated 13 July 2023.

Treaty changes

Tax treaties are agreements between countries that typically address withholding tax rates or exemptions on dividends, interest and royalties paid in multiple jurisdictions. Exceptions may apply based on the tax treaty (for instance, reduced rates may apply to certain categories of investors, capital gains from immovable property or property-rich companies may be taxable). All of the following tax treaty changes were effective in the third calendar quarter, except where indicated.

Countries involved		Summary of changes
Bangladesh	Iran	Provides general withholding tax rates of 15% on dividends, 10% on interest and 7.5% on royalties; exempts capital gains from tax (effective as of 21 March 2024 in Iran)
Hong Kong	Mauritius	Provides general withholding tax rates of 5% on dividends, interest and royalties; exempts capital gains from tax (effective as of 1 April 2024 in Mauritius)

Other considerations

Court decisions, regulations issued by tax authorities and other events may constitute new information that could trigger a change in judgment in recognition, derecognition or measurement of a tax position. These events also may affect your current or deferred tax accounting.

Federal, state and territories

Federal — In final regulations on split-waiver elections, the Internal Revenue Service (IRS) permits consolidated groups to waive carryback of consolidated net operating losses (CNOLs) that are attributable to an acquired member to pre-acquisition years during which the acquired member was a member of a former consolidated group. The final regulations apply to CNOLs arising in a tax year ending after 2 July 2020 but can be applied to any CNOLs arising in a tax year beginning after 31 December 2017. See **Tax Alert 2023-1220**, dated 12 July 2023.

In a revenue ruling, the IRS concluded that rewards from cryptocurrency staking must be included in gross income when the taxpayer can sell, exchange or otherwise dispose of the rewarded cryptocurrency. See **Tax Alert 2023-1388**, dated 10 August 2023.

In a notice, the Treasury Department provided temporary relief by deferring certain components of the final foreign tax credit regulations issued in 2021 and allowing taxpayers to determine whether a foreign tax qualifies for a credit based on the former regulations. For tax years ending on or before 31 December 2023, taxpayers may generally apply (1) the more permissive standards in pre-2021 regulations for determining whether a foreign tax was a creditable net income tax under IRC Section 901 and (2) the current IRC Section 903 "in lieu of" tax rules without regard to the attribution requirement. See **Tax Alert 2023-1315**, dated 26 July 2023.

In a separate notice, the IRS announced its intent to publish proposed regulations under IRC Section 174 on the cost recovery of specified research or experimental (SRE) expenditures. Topics to be covered in the proposed regulations include:

- How to apply the definitions of Section 174 amortization period and midpoint, and their application in short tax years
- How to identify SRE activities and allocate SRE expenditures
- Costs that are neither permitted nor required to be treated as SRE expenditures
- Costs that are considered incident to specified research or experimental activities or software development activities
- How to determine whether costs paid or incurred for research performed under a contract are SRE expenditures
- How to determine the treatment of unamortized SRE expenditures under IRC Section 174(d) if the taxpayer has a disposition, retirement or abandonment of property for which those SRE expenditures are paid or incurred

The notice also announced the IRS's intent to amend regulations under IRC Section 460 (long-term contract rules) and IRC Section 482 (cost-share arrangements) to reflect the impact of SRE expenditure capitalization under IRC Section 174.

Taxpayers are not required to apply the rules in notice but may apply them for tax years beginning after 31 December 2021, provided they rely on all the rules and apply them consistently. See Tax Alerts **2023-1526**, dated 13 September 2023, and **2023-1535**, dated 14 September 2023.

In another notice, the IRS described forthcoming regulations on the application of the corporate alternative minimum tax (CAMT), enacted under the Inflation Reduction Act of 2022. The forthcoming regulations will generally pertain to:

- The determination of a taxpayer's applicable financial statement

- The determination of adjusted financial statement income (AFSI) for members of a consolidated financial statement group
- AFSI adjustments to prevent certain duplications and omissions
- Tax consolidated groups
- The application of IRC Section 56A(c) to certain foreign corporations
- AFSI adjustments for certain income taxes, qualified wireless spectrum property and property to which IRC Section 168 applies, including IRC Section 481(a) adjustments for depreciation method changes

The IRS also outlined forthcoming rules on determining whether a corporation is an applicable corporation subject to the CAMT, as well as rules on aggregation under IRC Section 52, foreign-parented multinational groups, the treatment of investments in partnerships and the CAMT foreign tax credit. See **Tax Alert 2023-1570**, dated 20 September 2023.

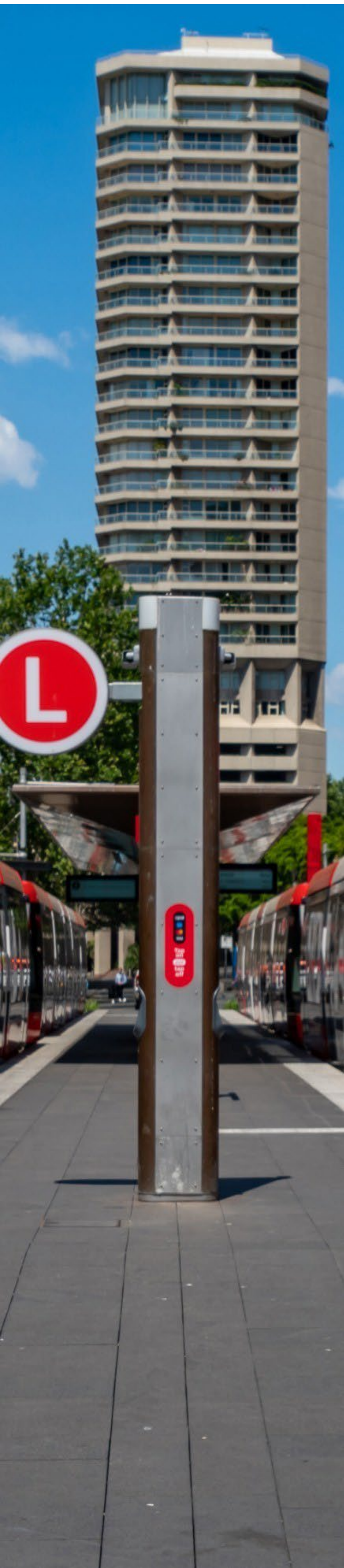
The US Court of Appeals for the Seventh Circuit affirmed a Tax Court holding that the owner of a professional basketball team could not deduct unpaid deferred compensation in the tax year ending with the team's sale, even though the owner had to include the associated liability assumed by the buyer when computing its gain on the sale. Like the Tax Court, the Seventh Circuit based its holding on IRC Section 404(a)(5), which only allows employers to deduct deferred compensation in the tax year in which the employee recognizes income (e.g., upon payment). See **Tax Alert 2023-1446**, dated 24 August 2023.

New Jersey — Following New Jersey's recent reform of the corporation business tax, the Division of Taxation (NJ DOT) updated related guidance on foreign corporations subject to tax, certain transactions involving intangibles and intellectual property, adding back interest expense of related members in certain tax years, and the unitary business principle and combined returns. See the **State and Local tax Weekly for 4 August 2023 and 11 August 2023**.

In separate guidance, the NJ DOT updated its guidance on nexus to reflect changes made to the Corporation Business Tax (CBT) (i.e., adopting a bright-line economic nexus standard and, in the context of combined reporting, adopting the *Finnigan* method to source New Jersey receipts). For discussion of the CBT changes, see the Enacted legislation section of this publication. The NJ DOT also revised its lists of activities that will and will not subject a company to New Jersey tax (i.e., activities that are protected or not protected under P.L. 86-272) to include internet activities and financial transactions.

Activities the NJ DOT views as subjecting a company to New Jersey tax (i.e., are unprotected under P.L. 86-272) include:

- Selling internet advertising services to New Jersey business customers that allow the taxpayer to provide targeted advertising to New Jersey individuals based on information mined from software, apps or cookies the taxpayer placed on the individual's computers or devices
- Offering, soliciting, selling, accepting or buying digital assets (e.g., virtual currency, non-fungible tokens) and offering services related to those assets
- Placing on New Jersey customers' computers or other electronic devices software or ancillary data (e.g., apps or cookies) that gather market or product research that is packaged and sold to data-brokers or other third parties
- Soliciting credit cards, other financial products and services from New Jersey customers
- Remotely fixing or upgrading New Jersey customers' products by transmitting code or other electronic instructions to those products over the internet as part of a subscription service purchased by the customer or as part of a warranty service contract
- Contracting with a marketplace facilitator to facilitate the sale of the corporation's products on the marketplace facilitator's online marketplace, where the marketplace facilitator maintains inventory, including that of the corporation, at fulfillment centers in New Jersey
- Contracting with New Jersey customers to stream (not download) videos and music to electronic devices



Activities that the NJ DOT views as not subjecting a company to New Jersey tax (i.e., are protected under P.L. 86-272) include:

- Placing on customers' computers or other electronic devices software, apps or cookies that are ancillary to soliciting orders that are neither sold to data brokers or other third parties nor used to gather data to sell services to the taxpayer's business customers
- Accepting electronic payment (e.g., credit card, other electronic method) for the online purchase of tangible personal property (this does not apply when the taxpayer is paid with a digital asset that the taxpayer resells, as part of its business, to an in-state customer)

Additionally, the NJ DOT explained that the state's adoption of the *Finnigan* method to source New Jersey receipts will preclude a combined group from claiming P.L. 86-272 protection if one member of a combined group has activities that are either not protected by, or exceed the protections of, P.L. 86-272. See **Tax Alert 2023-1527**, dated 13 September 2023.

Wisconsin — The Department of Revenue updated its guidance on Wisconsin's research expense credit to reflect that the state has not adopted changes made by the federal Tax Cuts and Jobs Act (P.L. 115-97) to IRC Sections 41, 174 and 280C, which took effect in 2022. See the **State and Local Tax Weekly for 18 August 2023 and 25 August 2023**.

Tax amnesties

This table shows tax amnesties that were announced or went into effect in the third quarter of 2023.

Jurisdiction	Amnesty period	Taxes covered	Reference
Dominican Republic	10 August 2023 through 20 December 2023	Corporate income taxes, capital gains, among others	**Tax Alert 2023-1420**, dated 18 August 2023

International

Finland — The Central Tax Board ruled that a Finnish company could claim foreign tax credits for taxes paid to Estonia following the transfer of its Estonian PE's earnings to Finland. Because the transferred earnings included profits from prior years, however, the Central Tax Board instructed the company to allocate the tax paid to the respective years and determine the credit based on the allocation. See **Tax Alert 2023-1379**, dated 9 August 2023.

India — The Mumbai Income Tax Appellate Tribunal (Mumbai Tribunal) held that no additional Indian tax will apply to payments that a Dutch company received for transportation and logistics services provided to its Indian affiliates despite the fact that the Dutch company constituted a PE in India. Citing a Supreme Court decision on PE profit attribution, the Mumbai Tribunal reasoned that no additional profits could be attributed to the affiliates because the transactions between the Dutch company and its affiliates were conducted at arm's length. See **Tax Alert 2023-1529**, dated 14 September 2023.

The New Delhi Income Tax Appellate Tribunal (New Delhi Tribunal) held that Indian tax did not apply to income that a Japanese company with multiple Indian Pes received from its offshore procurement and supply of goods. The New Delhi Tribunal reasoned that the income could not be attributed to the Indian PEs because they were not involved in the offshore procurement and supply of goods; the equipment provided to customers in India was manufactured in Japan and directly delivered to them. See **Tax Alert 2023-1529**, dated 14 September 2023.

Italy — The Supreme Court held that a French parent company was entitled to a refund of the difference between the ordinary capital gains tax that applies upon disposition of Italian stock and the reduced rate that applies under Italy's participation exemption regime. Denying the refund, the Supreme Court reasoned, would violate the law of the European Union (EU) by discriminating against the French company, which met the regime's requirements for the reduced rate. The availability of a tax credit would not eradicate the discrimination because the France-Italy treaty limited application of the credit to French taxes, the Supreme Court said. See **Tax Alert 2023-1505**, dated 11 September 2023.

OECD — The following jurisdiction deposited its instrument of ratification for the multilateral convention to implement tax treaty-related measures to prevent BEPS (MLI) this quarter:

- Tunisia (enters into force on 1 November 2023)
- Papua New Guinea (enters into force on 1 December 2023)

See **Tax Alert 2023-1529**, dated 14 September 2023.

Peru — In a ruling, the Tax Authority concluded that Peruvian income tax applied to income earned by a Peruvian tourism company from a Bolivian company that hired the Peruvian company to provide transportation service and tour guide services in Peru. The Peruvian Tax Authority also concluded that the outcome would not change if tax were withheld, or payment were made, in Bolivia. See **Tax Alert 2023-1371**, dated 7 August 2023.

In a separate ruling, the Tax Authority concluded that capital gains tax applied to a transfer of shares in a Peruvian company by one Colombian company to another following a demerger. Although the nondiscrimination clause of Decision 578 of the Andean Community precludes Peru from treating residents of member countries (i.e., Colombia) less favorably than Peruvian residents, the Tax Authority concluded that the nondiscrimination clause did not apply, as Peru's rules for tax-free treatment of demergers require all parties involved to be Peruvian residents. See **Tax Alert 2023-1346**, dated 1 August 2023.

In a decree, the Tax Authority outlined the formula that taxpayers must use to determine whether they have completed 80% of a building's construction by 31 December 2024, for purposes of determining whether they may claim the 33.33% maximum tax depreciation rate. It also outlines the criteria mining companies must satisfy to claim tax depreciation. For hybrid and electric vehicles, the Tax Authority noted that the depreciation rate for tax purposes cannot exceed the maximum 50% annual rate, even if depreciation for book purposes is lower. See **Tax Alert 2023-1353**, dated 7 August 2023.

In a ruling, the Tax Authority determined that the nondiscrimination clause in Peru's income tax treaties with Brazil, Chile and Canada applies exclusively to entities that qualify as residents of those countries under the treaty's terms. The nondiscrimination clause in Peru's income tax treaties with Switzerland, Mexico, Korea and Portugal, however, applies to both residents and nonresidents of those countries under the treaty's terms. The nondiscrimination clause prevents the treaty partners from treating foreign companies less favorably for tax purposes than domestic companies. See **Tax Alert 2023-1322**, dated 28 July 2023.

The Peruvian Supreme Court held that the Peruvian branch of a foreign company could not offset prior-year losses when determining its after-tax net income for distribution to the foreign company as deemed dividends. The Supreme Court reasoned that Peru's loss-offsetting regime only applies to Peruvian residents, so it could not extend to the Peruvian branches of a foreign company. See **Tax Alert 2023-1486**, dated 7 September 2023.

Spain — The Supreme Court accepted that general management and administrative expenses could be proportionally attributed to a foreign PE of a Spanish tax resident company, to the extent those expenses relate to the PE's activities. To support its decision, the Supreme Court relied on the domestic PE exemption provisions in the Spanish corporate income tax law, as the OECD commentary to the Model Tax Treaty is not legally binding and cannot be claimed before the Supreme Court. See **Tax Alert 2023-1529**, dated 14 September 2023.

Turkey — In a presidential decision, the government limited the 0% withholding tax rate on dividends deemed to be distributed as a result of a share buyback to Turkish corporations whose shares are traded on Borsa Istanbul. The new limit applies to shares acquired on or after 7 July 2023. See **Tax Alert 2023-1196**, dated 10 July 2023.

Things we have our eyes on

National, state and local governments continue to seek to increase their revenues. Companies should continue to monitor developments in this area. Some of these potential tax law changes are summarized here.

Federal, state and territories

BEAT — Rep. Ron Estes (R-Kan.) introduced a bill aimed at discouraging other countries from adopting the Undertaxed Profit Rule (UTPR) under Pillar Two of the OECD's BEPS initiative. The bill would impose reciprocal taxes on a foreign-controlled company whose parent operates in a jurisdiction that adopted the UTPR. To achieve this result, the bill would modify the base erosion and anti-abuse tax (BEAT), so it applies to those companies. See **Tax Alert 2023-1269**, dated 19 July 2023.

US-Taiwan Expedited Double Taxation Relief Act — The Senate Finance Committee unanimously approved a bill that would reduce the tax on US-source interest, royalties and gains paid to or received by a qualified resident of Taiwan to 10% from 30%. Tax on US-source dividends paid to or received by a qualified resident of Taiwan would decrease to 15%. A 10% rate would apply for certain owners of at least 10% of the shares of stock in a corporation, subject to limitations. The provisions would only become effective if Taiwan enacted corresponding tax reductions for US residents. See **Tax Alert 2023-1534**, dated 14 September 2023.

New York — The Department of Taxation and Finance proposed regulations under Article 9-A corporate franchise tax (Parts 1-9) and Article 33 insurance corporation franchise tax (Part 32). Once finalized, the proposed regulations will implement previously enacted franchise tax reform for corporations, banks and insurance companies.

The proposed regulations address a wide range of topics, including the imposition of tax (nexus) and protected/unprotected activities under PL 86-272, apportionment, computation of tax, combined unitary reporting and qualified New York State manufacturers. The effective date for the proposed regulations is currently unknown. See **Tax Alert 2023-1397**, dated 11 August 2023.

Texas — Governor Greg Abbott signed a bill that would increase the franchise tax exemption to $2.47 million from $1 million, beginning with reports originally due on or after 1 January 2024.

The increased exemption will only take effect if voters, during the 7 November 2023 general election, approve a constitutional amendment allowing property tax relief implemented in a separate bill, which the governor also signed. Accordingly, the increased exemption will be enacted for US GAAP purposes if the voters approve the constitutional amendment. See the **State and Local Tax Weekly for 4 August 2023 and 11 August 2023**.

International

Bermuda — The government proposed introducing a corporate income tax that would apply only to Bermuda businesses that are part of multinational enterprise (MNE) groups with annual revenue of €750m or more. The rate is currently undetermined but would fall within the range of 9% to 15%. If enacted, the corporate income tax would be effective for tax years beginning on or after 1 January 2025.

The government intends to align its proposed corporate income tax with the OECD's global minimum tax rules under Pillar Two, so that the tax will mitigate the top-up tax payable to other jurisdictions on profits earned in Bermuda. The tax will also leverage certain key scoping elements and definitions in the global minimum tax rules, such as the definitions of entity, group, MNE group, constituent entity and ultimate parent entity (UPE). See **Tax Alert 2023-1412**, dated 17 August 2023.

Brazil — In a provisional measure, the government changed how certain Brazilian investment funds are taxed. Closed-end funds will be taxed on their unrealized gains on a semi-annual basis, instead of upon the liquidation of the investment. Different tax rates will apply depending on the type of fund (short-term or long-term) and whether a liquidity event (e.g., an initial public offering) is involved.

For investment funds subject to specific regimes (e.g., private equity funds), a 15% rate will apply to gains only upon liquidity events. Similarly, a 15% rate will apply semi-annually and upon liquidity events to funds that do not qualify as investment entities.

The rules will be effective 1 January 2024. Transitional rules will apply for unrealized gains earned through 31 December 2023 by nonsubject closed-end funds. The rules will not be enacted for US GAAP purposes until the provisional measure is converted into law by the Brazilian Congress. See **Tax Alert 2023-1471**, dated 5 September 2023.

The government also proposed a bill that would eliminate deductions for interest on net equity paid or credited as a means of remunerating shareholders. If enacted, the change would be effective 1 January 2024. See **Tax Alert 2023-1477**, dated 6 September 2023.

Canada — In draft legislation, the Department of Finance proposed implementing the global minimum tax rules under Pillar Two of the OECD's BEPS 2.0 initiative, including a domestic minimum top-up tax, an IIR and a UTPR. It also proposed a domestic digital services tax, which would apply as of 1 January 2024, at the earliest, for digital services revenue earned from 1 January 2022. Assuming the rules apply as of 1 January 2024, in the first year of application, the tax would apply to Canadian digital services revenue earned from 1 January 2022 through 31 December 2024.

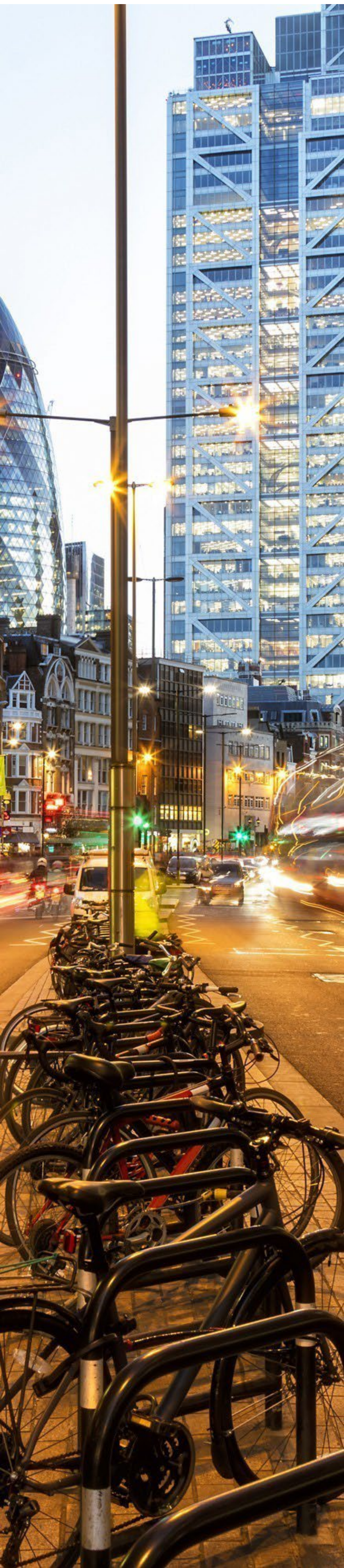
Other proposed changes include:

- Extending the 7.5% general corporate income tax rate for eligible income of qualifying manufacturers of zero-emission technology three years, so the reduced rate would begin phasing out for tax years beginning in 2032 (instead of 2029) and would return to 15% for tax years beginning after 2034 (instead of 2031)
- Imposing a 2% corporate tax on the net value of share buybacks by Canadian public corporations, similar to the stock buyback measure recently enacted in the US
- Limiting deductions for net interest expense to 40% of "tax EBITDA" for tax years beginning on or after 1 October 2023 and 30% of tax EBITDA for tax year 2024 and onward, with "tax EBITDA" generally defined as taxable income before taking interest income and expense, income tax and deductions for depreciation and amortization into account
- Modifying a previously proposed investment tax credit for capital investments in carbon capture, utilization and storage (CCUS) by splitting the credit into two components (a cumulative CCUS development tax credit and a CCUS refurbishment tax credit), expanding equipment eligible for the credit, and introducing new labor requirements to be eligible for the maximum credit rate
- Introducing a new tax credit for investment in clean technology equipment, with accompanying labor requirements that taxpayers would have to meet to claim the maximum credit rate
- Introducing new capital cost allowance classes 59 and 60, which would permit accelerated depreciation rates (100% for class 59 and 30% for class 60) for intangible exploration expenses and development expenses from storing captured carbon
- Broadening the types of expenses eligible for the critical mineral exploration tax credit and flow-through share regime to include eligible expenses from exploring and developing lithium from brines, beginning on or after 28 March 2023
- Broadening of the definition of "credit union" for Canadian income tax purposes, so that credit unions earning more than 10% of their revenue from specified sources (such as interest income from lending activities) qualify as a credit union (retroactively effective to 1 January 2016)
- Amending the general anti-avoidance rule by lowering the threshold for considering a transaction to be an avoidance transaction, adding an economic substance test for determining whether abusive tax avoidance exists, introducing a penalty equal to 25% of the tax benefit for undisclosed transactions and extending the normal period for GAAR assessments by three years for undisclosed transactions

See Tax Alerts **2023-1387**, dated 10 August 2023; **2023-1421**, dated 18 August 2023; **2023-1431**, dated 21 August 2023; **2023-1442**, dated 24 August 2023; and **2023-1456**, dated 28 August 2023.

Chile — As part of its new Fiscal Pact, the government announced that it would implement the OECD's global minimum tax rules under Pillar Two. Other tax-related aspects of the Fiscal Pact include:

- Increased depreciation
- Incentives for investment in small and medium-sized enterprises



- New tax credits for mining, lithium extraction, renewable energies and green hydrogen
- Tax incentives for investment in productivity
- Reduced tax exemptions

See **Tax Alert 2023-1377**, dated 8 August 2023.

Costa Rica — Congress overrode a partial presidential veto of a bill that would change Costa Rica's foreign-source income exemption regime, thereby allowing Costa Rica to be removed from the EU's list of noncooperative countries in tax matters. The bill will be enacted for US GAAP purposes upon publication in the Official Gazette.

Proposed changes in the bill include:

- Clarifying that income tax applies to income from Costa Rican sources and that Costa Rican sources are those within the national territory
- Taxing certain foreign-source passive income obtained by entities that belong to a multinational group and lack adequate economic substance
- Outlining the criteria an entity must meet to have adequate economic substance
- Aligning Costa Rica's definition of PE with the OECD's

See Tax Alerts **2023-1508**, dated 12 September 2023, and **Tax Alert 2023-1571**, dated 20 September 2023.

El Salvador — Congress approved bills to reform the International Services Law (ISL) and the Free Trade Zones Law (FTZL), which are El Salvador's two main free-trade regimes for goods and services. The bills would add activities that can benefit from tax incentives (including a corporate income tax exemption) and reduce current qualification restrictions. They would also clarify the areas within the regimes where taxpayers may operate. See **Tax Alert 2023-1369**, dated 4 August 2023.

Germany[1] — The Federal Ministry of Finance revised its March 2023 discussion draft legislation to implement the global minimum tax rules under Pillar Two of the OECD's BEPS 2.0 initiative. The current draft bill would:

- Modify the limit on deductions for royalties paid directly or indirectly to related parties in certain jurisdictions that tax the royalties at an effective tax rate of less than 15% instead of the current 25%
- Lower the low-tax threshold to 15% from 25% for controlled foreign corporation (CFC) tax purposes
- Require German constituent entities (e.g., subsidiaries) to reimburse their minimum tax group parent for top-up taxes that are attributable to them and paid by the parent
- Require minimum tax group parents to refund top-up taxes attributable to their German constituent entities if their constituent entities reimbursed them for those taxes
- Permit companies to elect to include all dividends from portfolio shareholdings in their computation of global anti-base erosion (GloBE) income or loss
- Permit companies to elect to include equity gain or loss in their computation of GloBE income or loss
- Permit companies to elect to exclude a debt release included in their financial accounting net income or loss from their computation of GloBE income or loss
- Include transitional rules for allocating taxes arising under blended CFC tax regimes

In separate draft legislation, the Ministry of Finance proposed significant changes to Germany's corporate income tax, including:

- Increasing the maximum R&D allowance to €3 million by tripling the maximum base used to determine the allowance to €12 million, allowing taxpayers to include the acquisition and production costs of depreciable movable fixed assets used in a qualifying R&D project in the maximum base and increasing the portion of expenses for contract R&D that can be included in the base to 70% from 60%

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[1] A Tax Alert has not been published on the current version of the bill. For discussion of the July 2023 version, see **Tax Alert 2023-1221**, dated 12 July 2023.

- Allowing companies to carry back tax losses up to three years instead of two
- Allowing companies to offset 80% (rather than 60%) of taxable income above €1 million with a tax loss carryforward for tax years 2024 through 2027
- Modifying the limit on deductions to require allocation of the €3 million threshold proportionally to net interest expense among the group members (as opposed to the current application of the full threshold for each individual entity separately)
- Denying deductions for interest paid to related parties to the extent the underlying interest rate exceeds a maximum rate defined by law (exceptions, while narrow, may apply)
- Modifying the rules for tax-neutral demergers so that a share transfer of 20% or less within five years after a tax-neutral demerger could cause the original demerger to be recharacterized, retroactively, as a third-party sale (exceptions may apply for affiliated parties of the transferor)
- Increasing the depreciation allowance for low-value assets
- Temporarily allowing accelerated depreciation for residences that a taxpayer constructed or acquired before the end of the year of completion, provided certain conditions are satisfied

See Tax Alerts **2023-1264**, dated 18 July 2023; **2023-1301**, dated 25 July 2023; and **2023-1481**, dated 6 September 2023.

In a draft decree, the Ministry of Finance outlined how to apply the German anti-hybrid rules, which were enacted in 2021 and generally apply to expenses accruing after 31 December 2019. The decree discusses financing transactions, reverse hybrid entities, double deductions, imported hybrid mismatches and scenarios in which payments are deducted but not included in the recipient's income, among other topics. See **Tax Alert 2023-1265**, dated 18 July 2023.

Gibraltar — The government announced that it would implement Pillar Two of the OECD's BEPS 2.0 initiative no earlier than accounting periods beginning on or after 31 December 2024. The government also plans to introduce a consultation process around a new tax regime, including tax incentives, that would comply with Pillar Two and include a domestic minimum top-up tax. See **Tax Alert 2023-1224**, dated 12 July 2023.

Hong Kong — The government proposed updates to a previously proposed safe harbor that would treat Hong Kong-sourced disposal gains from equity interests as nontaxable capital gains in Hong Kong, provided certain conditions are met. The updates would:

- Permit equity interests to be disposed in tranches, provided subsequent disposals occur within 24 months of the first disposal
- Permit investee entities engaging in property-related business to qualify for the safe harbor in certain cases
- Permit the safe harbor to apply when equity interests change from trading stock to capital asset, provided certain conditions are satisfied

Separately, the government proposed taxing foreign-sourced disposal gains from all asset classes under the foreign-sourced income exemption regime. Subject to formal agreement with the EU, there may be an exemption for traders' gains and deferral of tax on intra-group asset transfers. See **Tax Alert 2023-1441**, dated 24 August 2023.

In a consultation paper, the government proposed a new patent box regime that would tax eligible income from patents or patent-like intellectual property in Hong Kong at a concessionary rate. The new regime would comply with Action 5 of OECD's BEPS initiative. See **Tax Alert 2023-1507**, dated 12 September 2023.

Ireland — In a feedback statement for public consultation, the Department of Finance outlined possible legislative approaches for preventing the double non-taxation of certain cross-border payments of interest, royalties and dividends. These approaches could include imposing withholding tax on interest, royalties and dividends paid to recipients in certain low- or no-tax jurisdictions. The measures are expected to be reflected in Finance Bill 2023 and become effective at some point in 2024. See **Tax Alert 2023-1242**, dated 14 July 2023.

In a second feedback statement for public consultation, the Department of Finance outlined proposed draft legislation that would implement the EU minimum tax directive and corresponding global minimum tax rules under Pillar Two rules into Irish law, including transitional UTPR safe harbor, the QDMTT, the QDMTT safe harbor and various elections. See **Tax Alert 2023-1330**, dated 28 July 2023.

In a roadmap, the Department of Finance confirmed plans to introduce a participation exemption for foreign-sourced dividends, which would take effect at the beginning of 2025. The Department of Finance also advised that further analysis will be completed on the possible introduction of a foreign branch exemption. See **Tax Alert 2023-1543**, dated 15 September 2023.

Italy — In a draft legislative decree, the government proposed implementing Pillar Two's global minimum tax rules into Italian law, including an IIR, a UTPR and a QDMTT. The new rules would be effective beginning 1 January 2024 (with the UTPR becoming effective one year later). See **Tax Alert 2023-1517**, dated 13 September 2023.

Kenya — The Cabinet Secretary for National Treasury proposed new transfer pricing rules that reflect recent changes in Kenya's income tax law and would replace rules introduced in 2006. The proposed rules also align with the OECD's transfer pricing guidelines. Proposed changes include expanding the scope of transactions that are subject to transfer pricing. See **Tax Alert 2023-1509**, dated 12 September 2023.

Luxembourg — In draft legislation, the government proposed changes to the current two-part investment tax credit (ITC), including:

- Increasing the rate of the global ITC to 12% from 8% and eliminating the existing €150,000 cap
- Eliminating the 13% tax credit for complementary investments, which is determined by comparing the adjusted net book value of qualifying assets to the average net book value of those assets over the last five years

The government also proposed a new ITC to encourage Luxembourg businesses to invest in the digital transformation or energy and ecological transition. Under the new ITC, qualifying investments and business expenses would be eligible for an 18% ITC. To qualify for the new ITC, the investments or expenses would have to meet a list of objectives. Like the current ITC, both the global ITC and the new ITC could be carried forward for 10 years. See **Tax Alert 2023-1272**, dated 19 July 2023.

Separately, the government sent legislation to Parliament that would implement the EU minimum tax directive. The new regime would apply a 15% minimum effective tax rate for large multinational enterprises and large-scale domestic groups with annual revenues of at least €750 million in at least two of the last four tax years. It would also include a QDMTT, an IIR, an UTPR and a QDMTT safe harbor that would permanently reduce the top-up tax for a specific jurisdiction to zero under certain circumstances.

The IIR and QDMTT are proposed to apply to tax years beginning on or after 31 December 2023, while the UTPR would generally apply to tax years beginning after 31 December 2024. **See Tax Alert 2023-1396**, dated 11 August 2023.

OECD —The OECD released a statement reflecting the agreement reached by 138 of the 143 Inclusive Framework member jurisdictions on the remaining elements of the BEPS 2.0 project. According to the statement, the Multilateral Convention (MLC) for Pillar One Amount A will be opened for signature in the second half of 2023, and a signing ceremony will be arranged by year-end. The statement further references the objective of having the MLC enter into force in 2025. See **Tax Alert 2023-1223**, dated 12 July 2023.

Regarding Pillar One, the OECD released a consultation document with new information on the possible design of transfer pricing rules under Pillar One of the BEPS 2.0 initiative. The new rules would apply to in-country baseline marketing and distribution activities (i.e., Amount B). The new rules are intended for inclusion in the OECD's transfer pricing guidelines by January 2024. See **Tax Alert 2023-1316**, dated 26 July 2023.

Regarding Pillar Two, the Inclusive Framework released the second set of Administrative Guidance, which includes a Transitional UTPR safe harbor. Under this safe harbor, the UTPR top-up tax calculated for the UPE jurisdiction will be deemed to be zero if the UPE jurisdiction has a corporate income tax with a rate of at least 20%. This safe harbor applies for fiscal years that run no longer than 12 months and that begin on or before 31 December 2025 and end before 31 December 2026.

The Administrative Guidance also provides favorable treatment for transferable tax credits, such as those in the Inflation Reduction Act. Other topics include the design of a QDMTT, a QDMTT safe harbor, application of the substance-based income exclusion and currency conversion rules for global minimum tax calculations. See Tax Alerts **2023-1259**, dated 18 July 2023, and **2023-1292**, dated 21 July 2023.

Regarding the subject-to-tax rule (STTR), the OECD released a model tax treaty provision and related commentary that jurisdictions can use to incorporate the STTR in their bilateral tax treaties. The STTR is a treaty-based rule that applies to an intragroup payment if the payee's jurisdiction of residence taxes the payment at a rate below 9%. A multilateral instrument to facilitate implementation of the STTR in relevant bilateral tax treaties will be open for signature from 2 October 2023. See Tax Alerts **2023-1259**, dated 18 July 2023, and **2023-1302**, dated 25 July 2023.

South Africa — In draft legislation, the government proposed tax incentives for renewable energy, R&D and the Urban Development Zone. It also proposed adjusting the minimum royalty rate for oil and gas companies. Other proposals include:

- Codifying the interest deductibility principles in Practice Note 31 of 1994
- Limiting the exemption for foreign business establishments (in the application of the foreign-controlled company legislation) to companies whose primary functions are performed in-house and in-country, rather than outsourced
- Refining the provisions relating to unbundling transactions to clarify that any tax paid by the unbundling company on the distribution should be included in the basis of the unbundled shares only
- Refining the participation exemption for income from sales of shares in foreign companies

See **Tax Alert 2023-1352**, dated 2 August 2023.

South Korea — In its 2023 tax reform proposals, the Ministry of Economy and Finance proposed delaying the effective date of its previously enacted UTPR by one year, to 1 January 2025. It also proposed changes to its current global minimum tax rules, including:

- Narrowing the definition of "group" to exclude a company with only a stateless PE
- Aligning the definition of a PE with the OECD model rule
- Modifying the definition of UPE by adding the head office of a group and excluding a sovereign wealth fund
- Introducing a foreign exchange rate conversion method for the €750 million threshold in determining whether a company is subject to the global minimum tax into local KRW currency
- Narrowing the definition of constituent entities to allow only arbitrarily excluded entities, rather than all excluded entities, to qualify as constituent entities
- Requiring a head office's GloBE income or loss calculation to include a PE's loss if its domestic tax calculation includes the PE's loss
- Adding adjustment methods for GloBE income or loss due to increases or decreases of adjusted covered tax
- Adding a method for calculating top-up tax when the top-up tax percentage exceeds 15%
- Introducing new requirements for recognizing QDMTT if OECD/G20 administrative guidance exempts the parent entity from top-up tax
- Excluding tax-transparent entities from special rules for investment constituent entities
- Modifying the five-year UTPR exemption for groups in the early stages of overseas expansion to require those groups to apply for the exemption (effective for fiscal years beginning on or after 1 January 2025)

Unless otherwise indicated, the changes are proposed to be effective for fiscal years beginning on or after 1 January 2024. See **Tax Alert 2023-1351**, dated 7 August 2023.

Appendix

FASB moves forward with guidance to enhance income tax disclosures

Overview

The Financial Accounting Standards Board (FASB or Board) recently discussed stakeholder feedback on its proposal issued in March 2023 to require entities to provide more information in the rate reconciliation table and about income taxes paid, including certain disclosures that would be disaggregated by jurisdiction and other categories. At its meeting on 30 August 2023, the Board reaffirmed many of its previous decisions and made additional decisions related to the presentation of reconciling items, the disclosure of changes in unrecognized tax benefits, the effective date and transition, and other matters. The FASB also directed the staff to draft a final Accounting Standards Update (ASU) and expects to finalize guidance in the fourth quarter of 2023.

The proposal is intended to address investors' calls for more information about income taxes, particularly related to the rate reconciliation and income taxes paid information. The FASB had proposed broader changes to the income tax disclosure requirements in 2016 and 2019 but decided to focus on the rate reconciliation table and disclosures about income taxes paid after evaluating feedback on those proposals and responses to its 2021 *Invitation to Comment, Agenda Consultation*.

The guidance would align the rate reconciliation requirements in Accounting Standards Codification (ASC) 740, *Income Taxes*, with certain requirements of the Securities and Exchange Commission (SEC) Regulation S-X, and reduce diversity in practice by prescribing the categories of information entities present in the table. The guidance would eliminate certain existing requirements related to uncertain tax positions and unrecognized deferred tax liabilities and replace the term public entity with public business entity (PBE) in ASC 740.

Key considerations

Rate reconciliation

The guidance would require PBEs to disclose, on an annual basis, in their rate reconciliation table both percentages and amounts in their reporting currency for the following categories, with accompanying qualitative disclosures:[2]

- State and local income tax in the country of domicile, net of federal income tax effect
- Foreign tax effects, including any state or local taxes in foreign jurisdictions
- Enactment of new tax laws
- Effect of cross-border tax laws
- Tax credits
- Valuation allowances
- Nontaxable or nondeductible items
- Changes in unrecognized tax benefits

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[2] The proposed disclosure requirement would not apply to immaterial items in accordance with paragraph 105-10-05-6.

The last six categories in the list would apply to federal (national) income taxes imposed by the country of domicile. At its August meeting, the Board tentatively decided to require all reconciling items to be presented on a gross basis, unless specific guidance permits net presentation in the rate reconciliation table. The Board decided to allow entities to disclose on a net basis the effects of certain cross-border tax laws (e.g., GILTI) and related foreign tax credits. The Board also decided to permit entities to aggregate disclosure of changes in the unrecognized tax benefits category for all jurisdictions.

For foreign tax effects,[3] the effect of cross-border tax laws, tax credits and nontaxable or nondeductible items, the guidance would require further disaggregation when the individual reconciling items in the categories equal or exceed a threshold of 5% of the amount computed by multiplying the income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate.

Reconciling items in the foreign tax effects category that meet the threshold would have to be disaggregated by both jurisdiction (country) and nature. Reconciling items in the effect of the cross-border tax laws, tax credits and nontaxable or nondeductible items categories that meet the threshold would have to be disaggregated by nature. To determine the nature of a reconciling item, an entity would consider the item's fundamental or essential characteristics, such as the event that caused the reconciling item and the activity with which the reconciling item is associated.

If a foreign jurisdiction meets the 5% threshold, the tax impact for that category would be separately disclosed as a reconciling item in the foreign effects category. An entity would then evaluate whether any reconciling items in that jurisdiction should be separately disclosed based on the 5% threshold. In some cases, a jurisdiction may not meet the 5% threshold, but there could be individual reconciling items in that jurisdiction that meet the 5% threshold. Reconciling items in a foreign jurisdiction would be separately disclosed by nature (consistent with the categories listed above) if the gross amount of the individual reconciling item (positive or negative) meets the 5% threshold.

Any other reconciling item that meets the 5% threshold but does not fall in one of the listed categories would have to be disaggregated by nature. A PBE would also have to disclose the state and local jurisdictions that contribute to the majority of the effect of the state and local income tax category. The Board clarified at its August meeting that "the majority of the effect" means a simple majority (greater than 50%) of the effect of the state and local jurisdiction income tax category (i.e., disclose the largest contributing states and/or local jurisdictions that make up more than 50% of the effect of this category).

In addition, a PBE would have to provide an explanation, if not otherwise evident, of the individual reconciling items disclosed, such as the nature, effect and year-over-year changes of the reconciling items.

The Board also decided at its August meeting to align the disclosure requirements on the income tax rate that could be used for the rate reconciliation with the guidance in Regulation S-X Rule 4-08(h)(2), which allows a foreign entity to use a statutory income tax rate other than the income tax rate in its country of domicile and requires disclosure of the rate used and the basis for using such a rate when the rate used by an entity is other than the US federal corporate income tax rate.

The Board acknowledged that the proposed categories do not cover all possible income tax effects, and judgment could be required to determine how to categorize income tax effects that would not clearly be in one of the prescribed categories. The Board said companies would need to consider the proposed disclosure objective and consider making additional disclosures to explain the categorization of individual reconciling items.

Entities that are not PBEs would be required to provide qualitative disclosures about specific categories and individual jurisdictions that result in a significant difference between the statutory federal tax rate and the effective tax rate.

Income taxes paid

The Board decided at its August meeting to require all entities to disclose on an annual basis income taxes paid, net of refunds received, disaggregated by federal (national) taxes in the country of domicile, state taxes and foreign taxes. The state and local taxes category would reflect those paid in the country

[3] That is, taxes imposed by countries other than the country of domicile of the reporting entity.

of domicile, while foreign taxes would include all state and local taxes paid in the foreign jurisdictions. All entities would have to disclose annually income taxes paid, net of refunds received, by jurisdiction if the amount equals or exceeds a quantitative threshold of 5% of total income taxes paid (net of refunds).

Disaggregated domestic and foreign income statement disclosures

The guidance would require all entities to disclose the following income statement information in addition to what is already required:

- Income (or loss) from continuing operations before income tax expense (or benefit), disaggregated between domestic and foreign
- Income tax expense (or benefit) from continuing operations, disaggregated between federal or national, state and foreign

The guidance to disclose this information would be similar to the guidance applied by public companies required by SEC Regulation S-X 210.408(h)1.

The guidance would require income tax expense and income taxes paid on foreign earnings that are imposed by the jurisdiction of domicile to be included in the amount for that jurisdiction of domicile. For example, income taxes on GILTI of a US reporting entity would be classified as federal because the income tax is imposed by the US government.

Undistributed earnings of subsidiaries and corporate joint ventures

The guidance would eliminate the requirement to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition in ASC 740-30 related to subsidiaries and corporate joint ventures. For example, an entity would no longer be required to disclose the cumulative amount of undistributed earnings when it asserts that it is indefinitely reinvesting foreign earnings. However, the entity would still be required to make disclosures about unrecognized deferred tax liabilities under ASC 740-30-50-2(c).

Unrecognized tax benefits

The guidance would eliminate for all entities the requirement to disclose certain information when it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date.

Use of the term PBE

The guidance would eliminate references to a public entity in ASC 740 and replace them with the term public business entity, which is defined in the ASC Master Glossary.

How we see it

The guidance would require entities to provide more disclosures than are currently required for the rate reconciliation and income taxes paid. Entities should evaluate whether additional processes and controls would be necessary to obtain all of the information they would need to provide the new disclosures.

Effective date and transition

The Board decided all entities would apply the guidance prospectively, with the option to apply it retrospectively. The guidance would be effective for PBEs for fiscal years beginning after 15 December 2024, and interim periods within fiscal years beginning after 15 December 2025. It would be effective for other entities for fiscal years beginning after 15 December 2025, and interim periods within fiscal years beginning after 15 December 2026. Early adoption would be permitted.

Appendix: Illustration of rate reconciliation disclosure under proposal

The guidance would include the following illustration[4] of a rate reconciliation to be disclosed by a PBE in accordance with paragraph 740 10-50-12A. In the illustration, the entity is domiciled in the US and presents comparative financial statements. For the disclosure of foreign tax effects in accordance with paragraph 740-10-50-12A(b)(2), it is assumed that the 5% threshold, computed by multiplying the income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate of the jurisdiction of domicile, is met:

a. For Ireland, both at the jurisdiction level and for certain individual reconciling items of the same nature within Ireland

b. For the United Kingdom, for certain individual reconciling items of the same nature within the United Kingdom, but not at the jurisdiction level

c. For Switzerland and Mexico, at the jurisdiction level, but not for any individual reconciling items of the same nature within each jurisdiction

	Year Ended December 31, 20X2		Year Ended December 31, 20X1		Year Ended December 31, 20X0	
	Amount	Percent	Amount	Percent	Amount	Percent
US Federal Statutory Tax Rate	$ AA	aa %	$ BB	bb %	$ CC	cc %
State and Local Income Taxes, Net of Federal Income Tax Effects*	AA	aa	BB	bb	CC	cc
Foreign Tax Effects						
United Kingdom						
Tax rate differential	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Share-based payment awards	AA	aa	BB	bb	CC	cc
Changes in unrecognized tax benefits	(AA)	(aa)	(BB)	(bb)	CC	cc
Other	(AA)	(aa)	BB	bb	(CC)	(cc)
Ireland						
Tax rate differential	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Valuation allowances adjustments	(AA)	(aa)	(BB)	(bb)	CC	cc
Enactment of new tax laws	-	-	BB	bb	-	-
Other	AA	aa	(BB)	(bb)	(CC)	(cc)
Switzerland	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Mexico	AA	aa	BB	bb	CC	cc
Other foreign jurisdictions	(AA)	(aa)	(BB)	(bb)	CC	cc
Enactment of New Tax Laws						
Change in tax rate	-	-	-	-	(CC)	(cc)
Effect of Cross-Border Tax Laws						
Global intangible low-taxed income	AA	aa	BB	bb	CC	cc
Foreign-derived intangible income	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Base erosion and anti-abuse tax	AA	aa	BB	bb	CC	cc
Other	AA	aa	-	-	-	-
Tax Credits						
Research and development tax credits	-	-	(BB)	(bb)	(CC)	(cc)
Energy-related tax credits	(AA)	(aa)	-	-	-	-
Other	-	-	(BB)	(bb)	-	-
Valuation Allowances	AA	aa	(BB)	(bb)	(CC)	(cc)
Nontaxable or Nondeductible Items						
Share-based payment awards	AA	aa	BB	bb	CC	cc
Goodwill impairment	AA	aa	BB	bb	-	-
Other	AA	aa	(BB)	(bb)	CC	cc
Changes in Unrecognized Tax Benefits	(AA)	(aa)	BB	bb	(CC)	(cc)
Other Adjustments	AA	aa	(BB)	(bb)	(CC)	(cc)
Effective Tax Rate	$ AA	aa %	$ BB	bb %	$ CC	cc %

* State taxes in California and New York contributed to the majority of the tax effect in this category.

[4] ASC 740-10-55-231.

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