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Legislation

US Congress approves new CR, complicates options for year-end tax bill

The US House and Senate in mid-November approved a two-step continuing resolution (CR) to extend federal government funding beyond the 17 November deadline to avert a government shutdown. Under the plan, certain appropriations bills would be extended through 19 January 2024, and the remainder of appropriations through 2 February. President Biden signed the bill into law late on 16 November.

The approval of the two-step continuing resolution to extend federal government funding into early 2024 means there will not be a must-pass year-end appropriations bill to which such tax packages are typically appended. It remains to be seen whether tax provisions can be added to spending bills either in January or February, or possibly to other legislation sometime between now and then.

A business tax package would likely center around *Tax Cuts and Jobs Act* (TCJA) pre-cliffs that relate to the five- or 15-year amortization for R&D expenses, rather than expensing under Section 174 and the Section 163(j) interest deduction limitation based on earnings before interest and taxes (EBIT) rather than earnings before interest, taxes, depreciation and amortization (EBITDA), both of which took effect in 2022, and 100% expensing, which is phased down after 2022.

Any deal would likely require achieving some parity between the cost of addressing those provisions and an expansion of the child tax credit, which is backed by Democrats.

House Ways and Means Committee clears US-Taiwan tax bill

The US House Ways and Means Committee on 30 November unanimously approved the bipartisan *United States-Taiwan Expedited Double-Tax Relief Act* (H.R. 5988), under which income from US sources earned or received by qualified residents of Taiwan would be entitled to certain benefits. H.R. 5988, which would add Section 894A to the Code, was

US proposes new timeline for BEPS Pillar One MLC

A Treasury official in mid-November was quoted as saying that the US is proposing a new timeline for the signing deadline for the BEPS 2.0 [Multilateral Convention to Implement Amount A of Pillar One](#) (MLC). The OECD released the text in October.

The MLC would update the global international tax framework to “coordinate a reallocation of taxing rights to market jurisdictions, improve tax certainty, and remove digital services taxes.” The Treasury official also reportedly reiterated that it was important that countries not impose any new digital services taxes.

amended to add a new provision that would authorize the President to negotiate and enter into one or more non-self-executing tax agreements to provide for bilateral tax relief with Taiwan after a determination is made that Taiwan has provided benefits to US persons that are reciprocal to the benefits provided under Section 894A. The new provision is similar to the Senate Foreign Relations Committee proposal released earlier in the year authorizing the negotiation of a tax agreement with Taiwan.

Subject to reciprocity requirements, the Ways and Means bill would reduce the general statutory 30% withholding tax on certain US-source income received by qualified residents of Taiwan.

Both Chairman Jason Smith (R-MO) and Ranking Member Richard Neal (D-MA) highlighted the bill’s reciprocity requirements, under which the bill’s provisions apply only if reciprocal provisions apply to US persons with respect to income sourced in Taiwan.

Chairman Smith and Ranking Member Neal made comments suggesting the bill is ready to be brought to the House floor and could receive a vote soon. The Taiwan tax issue has bipartisan support and is rooted – at least in part – by interest in boosting semiconductor chip production. The Taiwan bill is considered a candidate to be attached to a broader tax measure.

Courts

Tax Court rules non-US partnership was securities dealer engaged in US trade or business, liable for partnership withholding tax

The US Tax Court in November 2023 held in *YA Global Investments, LP v. Commissioner* that a foreign partnership providing funding to certain portfolio companies was considered to have a US office because its US-based asset manager acted as its agent. Consequently, the partnership was engaged in a US trade or business and liable for withholding tax under Section 1446 on the portion of its taxable income that was effectively connected with that trade or business and allocable to foreign partners.

The court also found that the limitations period for the assessment never started because the partnership filed Form 1065, *U.S. Return of Partnership Income*, for the relevant years, but did not file Form 8804, *Annual Return for Partnership Withholding Tax (Section 1446)*.

The court concluded that the taxpayer was engaged in a trade or business beyond the Section 864(b)(2)(A) trading in stocks or securities safe harbor. The court focused on the fact that the taxpayer earned fees that were compensation for services, rather than simply earning a return on invested capital. Many alternative asset managers have sought to limit the receipt of fees by an investment fund for precisely this reason, and this case may cause funds and management companies to be even more cautious regarding the receipt of these fees.

Section 892 investors should be aware that certain portfolio fees earned by asset managers and paid to limited partners may cause the Section 892 partner to potentially be engaged in a commercial activity.

US-Chile tax treaty ratified by Chilean Congress, closer to entering into force

On 15 November 2023, the Chilean Senate approved the US-Chile income tax treaty. As a next step, the treaty must now be ratified by the Chilean President. The treaty shall enter into force once respective diplomatic notes are exchanged between the United States and Chile.

US court denies DRD after applying economic substance doctrine

A US District Court in *US v. Liberty Global* denied a company's dividends-received deduction under Section 245A after applying the codified economic substance doctrine (the Codified ESD) under Section 7701(o).

In the 31 October decision, the court took a broad view of the Codified ESD, rejecting the company's argument that the doctrine was limited to transactions to which it is "relevant." The decision represents a timely reminder to taxpayers about the role and importance of the common law ESD, including its application to multi-step transactions.

Treasury and IRS news

IRS issues proposed regulations on QBUs, including simplified elections for determining Section 987 gain or loss but restrictions on loss recognition

Treasury and the IRS on 9 November 2023 released proposed regulations ([REG-132422-17](#)) under Section 987 with guidance on determining taxable income or loss and currency gain or loss with respect to a qualified business unit whose functional currency differs from its tax owner (a Section 987 QBU).

The proposed regulations provide welcome guidance on the application of Section 987.

Canada confirms plans for DST, may lead to US response

The Canadian government presented its 2023 Fall Economic Statement on 21 November, confirming its intention to proceed with plans to enact a 3% Digital Services Tax (DST) in 2024, setting the stage for a possible showdown with the US government. The proposed Canadian DST would be effective 1 January 2024 and apply retroactively to 1 January 2022. Bipartisan members of Congress have warned that the United States "would examine all options, including under our trade agreements and domestic statutes," if Canada introduces the DST.

The proposed rules retain the basic approach and structure of the regulations finalized in 2016 and 2019, including the foreign exchange exposure pool (FEEP) method, while adopting simplifications, including elections to (1) treat all items of a Section 987 QBU as marked items (subject to a loss suspension rule) (the Current Rate Election), and (2) recognize all foreign currency gain or loss with respect to a Section 987 QBU on an annual basis (the Annual Recognition Election).

The proposed regulations also include new transition rules, which require the computation and disclosure of pre-transition Section 987 gain or loss, but generally delay the recognition of any such pre-transition gains and losses.

With the proposed regulations, Treasury and the IRS apparently are seeking to strike a balance between reducing the compliance burden on taxpayers while addressing concerns over the selective recognition of Section 987 losses.

Once finalized, the proposed regulations (and the parts of the 2016 final regulations and the 2019 final regulations that are not replaced or modified by the proposed regulations) would apply to tax years beginning after 31 December 2024.

To prevent taxpayers from avoiding the application of the proposed regulations by terminating Section 987 QBUs, the proposed regulations would apply beginning on the day a Section 987 QBU terminates on or after 9 November 2023. This date would also apply to terminations resulting from an entity classification election that is made on or after 9 November 2023, and effective before that date, if the 2016 final regulations and the 2019 final regulations would not apply to the Section 987 QBU. Thus, a Section 987 QBU that terminates on or after 9 November 2023, is subject to the loss deferral rules. Finally, all taxpayers with Section 987 QBUs are currently subject to the deferral rules of Reg. Section 1.987-12.

Taxpayers (and each member of their consolidated group) and their controlled foreign corporations may choose to apply the proposed regulations in their entirety to a tax year and all subsequent tax years beginning on or before 31 December 2024.

Although the regulations would generally not apply until tax years beginning after 31 December 2024 (unless early adopted), taxpayers should begin to take various steps in anticipation of transitioning to the new rules.

First, taxpayers should determine whether they have applied an eligible pre-transition method under Section 987 for each of their Section 987 QBUs, calculate the amount of pre-transition gain or loss with respect to their Section 987 QBUs, and gather supporting documentation.

Taxpayers that have not applied an eligible pre-transition method will have to compute annual unrecognized Section 987 gain or loss under the proposed regulations for each year since the inception of the Section 987 QBU until the transition date. Taxpayers should begin preparing now to address the substantial compliance burden.

Second, taxpayers should carefully monitor whether any Section 987 QBUs are terminated on or after 9 November 2023, including terminations resulting from check-the-box elections made after 9 November 2023, but effective before that date.

Such terminating Section 987 QBUs must immediately transition to the proposed regulations, which may result in the deferral of Section 987 losses.

Taxpayers should also begin to consider whether the default FEEP Method or simplifying elections are the most optimal way of applying the proposed regulations.

CAMT and stock-buyback excise guidance soon, PTEP regs coming first half of 2024

IRS and Treasury officials in mid-November confirmed that the government is expected to release both corporate alternative minimum tax guidance and stock buyback excise tax guidance before the end of 2023. The coming guidance is considered "high priority" and reportedly will be extensive.

The government also now expects proposed previously taxed earnings and profits (PTEP) regulations to be released in the first half of 2024, according to an IRS official. An official earlier this fall said PTEP regulations would be issued in early 2024. The initial proposed regulations – which will be released in tranches – reportedly will cover shareholder- and foreign corporation-level accounting rules, Section 961(c) basis, currency gain or loss and issues related to controlled foreign corporations that are owned through a partnership or that involve split-ownership structures.

OECD developments

OECD, country officials discuss BEPS 2.0 Pillars One and Two and other OECD tax work

The US Council for International Business and the OECD held their annual tax conference in Washington, DC, on 30-31 October 2023, with the bulk of the discussion focused on developments with respect to BEPS 2.0 Pillars One and Two.

There were also sessions on the OECD's work on global mobility of workers, carbon mitigation and tax certainty.

Senior members of the OECD Secretariat participated in the conference, along with tax officials from several Inclusive Framework member countries who are responsible for their countries' participation in the tax work of the OECD.

The discussion at the conference underscored the strong political momentum with respect to Pillar Two global minimum taxes and continuing political interest in all aspects of Pillar One. It also reinforced that there continue to be divergent views among Inclusive Framework jurisdictions on aspects of both pillars.

Hungary authorizes new CAA with US on exchange of CbC reports

The Hungarian government reportedly has authorized the signing of a new Hungary-US competent authority agreement (CAA) for the automatic exchange of country-by-country reports, according to a Hungarian Decree published in the *Official Gazette* on 2 November. A prior 2018 agreement was terminated effective on 8 January 2023, the same day that the Hungary-US income tax treaty was terminated.

Addressing Pillar One, US Assistant Treasury Secretary for Tax Policy Lily Batchelder said that Congress ultimately will need to approve the Pillar One Amount A multilateral convention (MLC), underscoring the critical need for input from business stakeholders during Treasury's MLC consultation, given the novel and complex design for new taxing rights in Amount A. The Treasury official said developing a consensus text is critical, with the objective being to create stability in the global tax system, eliminate digital services taxes and promote certainty.

Batchelder also reiterated the Biden Administration's support for Pillar Two and pointed to the simplification that she believes will result for US business, relating to how Pillar Two taxes are collected and the fact that other countries' Pillar Two taxes would be turned off if the US is in compliance. She added that the US continues to work with its Inclusive Framework partners on additional administrative guidance and said that an important priority for the US continues to be the treatment of the US R&D tax credit, indicating that the US continues to raise this issue in the multilateral negotiations on future guidance and that she is hopeful there will be progress.

OECD announces 48 jurisdictions to implement CARF by 2027

The OECD on 10 November announced that 48 countries and jurisdictions, including the United States, have pledged to implement the OECD Crypto-Asset Reporting Framework (CARF) by 2027. CARF provides for the automatic exchange of tax information on crypto-assets.

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