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Washington Dispatch

July 2024, Volume 28, Issue 7

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In this issue

Legislation

2. US Congress begins August recess

Courts

2. US Supreme Court overrules Chevron deference to agency regulations

3. US appellate court rules nonresident's gain from sale of its US partnership interest attributable to inventory is not US source income

IRS news

4. Final Section 367(b) regulations address certain cross-border triangular reorgs and inbound nonrecognition transactions

5. IRS officials offer update on CAMT, PTEP guidance

Transfer pricing

5. IRS and Medtronic file appellate briefs in Eighth Circuit appeal arguing for different transfer pricing methods

5. IRS representative says corporations that failed to respond to transfer pricing compliance letters have been referred for possible examination

OECD developments

6. G20 Finance Ministers, Central Bank Governors reiterate support for BEPS 2.0

6. Inclusive Framework on BEPS finalizing MLC to implement Pillar One Amount A, Amount B consensus near

6. OECD releases sixth edition of Corporate Tax Statistics publication

Legislation

US Congress begins August recess

The US Congress has adjourned for the August 2024 recess and will return after Labor Day. In one of its final acts before leaving Washington, the Senate voted not to begin consideration of the House-passed *Tax Relief for American Families and Workers Act* (H.R. 7024) package. The 1 August procedural vote failed as expected in the Senate. The vote was 48-44, with 60 votes required.

The bill would expand the Child Tax Credit and Low-Income Housing Credit and address the *Tax Cuts and Jobs Act* (TCJA) pre-cliffs on Section 174 five-year (research and development (R&D) amortization, Section 163(j) interest deductibility and tax treaty benefits with Taiwan, among other measures. The bill originally passed the House on 31 January.

With the procedural vote failing to garner sufficient support, it is unlikely that the Senate will pass the bill, at least before the November election, though Senate Majority Leader Chuck Schumer (D-NY) expressed some hope for reconsideration after the August recess.

Work is expected to continue during the August recess to lay the groundwork for the expiration of TCJA provisions at the end of 2025, at least for House Republicans, with tax teams active and at least one Committee hearing expected.

In the fall, addressing the expiration of both government funding and the farm bill on 30 September are the only must-do items. These could easily be put off until after the elections with short-term patches, however.

Courts

US Supreme Court overrules Chevron deference to agency regulations

In *Loper Bright Enterprises v. Raimondo*, No. 22-451 (June 28, 2024), a majority of the US Supreme Court (Court) overturned the 40-year precedent in *Chevron U.S.A. Inc v. Natural Resources Defense Council, Inc.*, which had been a mainstay precedent instructing courts to defer to the decisions of federal agencies when a statute is ambiguous. In place of the so-called *Chevron* deference, the majority opinion in *Loper Bright* held that courts must exercise their independent judgment when interpreting statutory language.

Loper Bright involved application of the *Chevron* doctrine to evaluate the validity of rules promulgated by federal agencies. The *Chevron* doctrine required courts to use a two-step framework to evaluate the validity of agency rules — including regulations. First, the court had to assess whether Congress had directly spoken to the precise question at issue. If so, then the court had to apply the statute as Congress intended. If not, and the statute was ambiguous, the court proceeded to step two of the *Chevron* analysis. Under step two, the court had to defer to the agency's interpretation if it was based on a permissible construction of the statute.

Chief Justice John G. Roberts, Jr., writing for the Court in a majority opinion, found that *Chevron's* two-step analysis is "misguided" because courts, not agencies, have special competence in resolving statutory ambiguities. In expressly overturning *Chevron*, Chief Justice Roberts states that, rather than deferring to agencies, courts "must exercise their independent judgment in deciding whether an agency has acted within its statutory authority."

While rejecting *Chevron* deference, the majority opinion still instructs courts to give "[c]areful attention" and "respect" to the views of federal agencies when properly presented through various rules, including regulations. The majority opinion also allows that, in some instances, Congress has expressly delegated lawmaking authority to an agency, in which case some level of deference would be consistent with the statute itself. But a court may not defer to an agency interpretation of a statute "simply because a statute is ambiguous."

The Supreme Court's overruling of *Chevron*, a mainstay precedent informing the weight given to Treasury regulations for decades, has potentially broad implications for the Treasury Department and the IRS going forward.

A large body of case law has developed around the issue of *Chevron* deference, informing how courts should determine the validity and weight of Treasury regulations. Courts now must apply the standard announced in *Loper Bright* and grapple with new issues such as:

- The scope of the *Loper Bright* standard
- The application of *Loper Bright* to the varying grants of rulemaking authority
- The contours of the "respect" or "careful attention" that courts must now give agency actions, as opposed to "deference"
- The extent that *stare decisis* will apply to the *Chevron*-era cases

Because *Loper Bright* makes the courts the ultimate arbiter of these critical questions, clarity on these issues will only come over time as the courts begin to apply the *Loper Bright* standard to Treasury regulations in actual cases and controversies. The ultimate resolution of these questions could result in Treasury regulations that are substantially the same as would have been allowed under *Chevron* deference; such a determination, however, will require substantial time to play out through the lower courts› actual application of the new standard.

In the meantime, many taxpayers may consider challenging the positions taken by Treasury and the IRS in certain regulations. In evaluating the technical merits of a challenge, taxpayers should consider their dispute strategy and compliance plan. For example, taxpayers may want to file an amended return or may wish to "wait-and-see" while ensuring the statute of limitations does not lapse. Taxpayers should also consider follow-on quantitative and qualitative consequences of an alternative statutory interpretation. For example, an alternative position may impact taxpayers' results under multiple code provisions and multiple years.

US appellate court rules nonresident's gain from sale of its US partnership interest attributable to inventory is not US source income

In *Rawat v. Commissioner*, No. 23-1142 (D.C. Cir. July 23, 2024) (*Rawat*), the US Court of Appeals for the DC Circuit (Court of Appeals) reversed a Tax Court decision (T.C. Memo 2023-14) that sourced inventory gain arising from the sale of a US partnership interest as though the taxpayer had actually sold the inventory that gave rise to the gain.

The Court of Appeals determined that while Section 751(a) requires gain from the sale of a partnership interest attributable to inventory to be taxed as ordinary income (rather than capital gain), it does not operate to change the character of the asset being sold from a partnership interest to inventory itself. Thus, with respect to a sale of the partnership interest for the tax year at issue, the Court of Appeals found that Section 751(a) does not treat inventory gain as income from the sale of inventory and as such, the taxpayer realized foreign source income under Section 865(a) that was not subject to US federal income tax.

With the enactment of Section 864(c)(8), the relevance of the *Rawat* decision with respect to sourcing may be limited to transactions that predate the TCJA. In the partnership context, subchapter K generally applies both aggregate and entity principles to the US federal tax treatment of partnerships, and typically views the sale of a partnership interest under entity principles.

The *Rawat* decision supports the notion that entity principles prevail in the context of a sale or exchange of a partnership interest, subject to an overriding provision enacted in the Code. With respect to any taxpayers that have taken a position based on the Tax Court's holding that gain or loss from a sale by a US person of a partnership interest in a foreign partnership with foreign activities is foreign source income, such an approach is unlikely to prevail under the Court of Appeals' rationale.

Congressional Republicans react to *Loper Bright*

There was a flurry of activity on Capitol Hill following the US Supreme Court decision in *Loper Bright Enterprises v. Raimondo*, which overturned *Chevron* deference.

On 12 July, Senator Rand Paul (R-KY) announced he was joining Senator Eric Schmitt (R-MO) in establishing a "Post-*Chevron* working group" that will meet regularly to discuss the "monumental decision in *Loper Bright*, how to best limit the unlawful exercise of power by the administrative state, and how the Senate can more effectively legislate on matters that regularly would've been left up to agency deference." Sixteen Republican senators, in addition to Sens. Paul and Schmitt, have signed on to the working group.

On the House side, Majority Leader Steve Scalise (R-LA) announced on 10 July that House Republican Committee chairs sent letters to their corresponding departments and agencies requesting review of "various overreaching regulations."

Canada moves forward with DST, House Republicans react

In a closely watched development, the Canadian government on 3 July 2024 posted an Order in Council on the government's website fixing the date Canada's *Digital Services Tax Act* (DSTA) comes into force as 28 June 2024. The DSTA implements a domestic digital services tax (DST) on certain revenue earned by large businesses from certain digital services that engage Canadian users; it is considered an interim measure until an acceptable OECD/G20 BEPS 2.0 Pillar One multilateral approach can be implemented.

US House Ways & Means Committee Chairman Jason Smith (R-MO) and Trade Subcommittee Chairman Adrian Smith (R-NE), in an 11 July letter signed by every Republican on the Committee, called on United States Trade Representative Katherine Tai to utilize authorities under Section 301 of the Trade Act to send a strong response to Canada's decision to impose a DST on US businesses "given the threat the DST poses to American workers and businesses."

IRS news

Final Section 367(b) regulations address certain cross-border triangular reorgs and inbound nonrecognition transactions

Treasury and the IRS released final regulations 17 July (TD 10004; Final Regulations) under Section 367(b) on the treatment of property used to acquire parent stock or securities in connection with certain cross-border triangular reorganizations and inbound nonrecognition transactions. The final regulations, which are effective 17 July 2024, adopt the proposed regulations without substantive changes.

Consistent with the Proposed Regulations, the Final Regulations modify certain aspects of the existing regulations under Section 367(b) (Existing Regulations) to incorporate, with certain modifications, guidance described in Notice 2014-32 (2014 Notice) and Notice 2016-73 (2016 Notice and collectively, the Notices).

The two Notices targeted complex transactions involving cash or other high-basis property transferred directly or indirectly from a foreign corporation to its US shareholder. The government believed the transactions were intended to avoid the taxable repatriation of Section 959(c)(3) earnings and profits when the US tax rate was 35%.

In recognition of the enactment of the 2017 *Tax Cuts and Jobs Act* (TCJA) — which introduced the Section 245A dividend received deduction (DRD) and the global intangible low-taxed income (GILTI) rules — the Final Regulations (like the Proposed Regulations) significantly reduce the number of targeted repatriation transactions.

The final regulations apply retroactively to the dates when the pre-TCJA repatriation Notices and the proposed regulations were released.

More specifically, the Final Regulations narrow the scope of the "excess asset basis" (EAB) rules in the 2016 Notice. In light of the increased prevalence of previously taxed earnings and profits (PTEP) after the TCJA, the Final Regulations also treat a foreign acquired corporation as receiving a deemed distribution under Section 301 from its foreign subsidiaries instead of adjusting an exchanging shareholder's all earnings and profits (E&P) amount as described in the 2016 Notice.

Given the complexity introduced by the Final Regulations, taxpayers that had not previously assessed the impact of the Proposed Regulations, including the implications of the expansive definition of foreign subsidiary, would be prudent to carefully review the rules and examples in the Final Regulations and assess the impact of these rules on their transactions.

Furthermore, cross-border transactions may create unexpected challenges if, for example, the requirements of the Section 245A DRD are not met (e.g., due to US shareholder status, holding period, US-source E&P, hybrid dividends, or extraordinary disposition accounts). Additionally, shareholders that are generally ineligible for the Section 245A DRD, such as individuals and corporate shareholders owning less than 10%, should carefully consider the effects of these rules on foreign corporation restructurings and other transactions.

IRS officials offer update on CAMT, PTEP guidance

An IRS official in July 2024 was quoted as saying proposed corporate alternative minimum tax (CAMT) regulations will generally follow the guidance in [Notice 2024-10] in regard to controlled foreign corporation (CFC) distributions to US shareholders or other CFCs. In Notice 2024-10, the IRS addressed the impact that certain CFC distributions have on a taxpayer's applicable financial statement income (AFSI), providing guidance that was expected to significantly reduce the potential for duplication of items in the taxpayer's AFSI.

The IRS official said the government is considering all options, but "it's fair to read the notice as a signal of the direction that we're going to take."

The official also clarified that the coming proposed rules will have broader applicability than Notice 2024-10 and not be limited to CFCs but also address deemed dividends and stock sales.

Proposed CAMT regulations continue to be a high priority, the official said, while declining to provide a timeline.

Another IRS official in late July was quoted as saying long-delayed previously taxed earnings and profits (PTEP) regulations are in the "home stretch" before their release. The official confirmed earlier statements that regulations will come in two tranches. The first release reportedly will address the interplay of foreign currency gain or loss and PTEP distributions among two CFCs, and basis issues related to CFC stock owned by a partnership. The second tranche will cover nonrecognition transactions, he said.

Transfer pricing

IRS and Medtronic file appellate briefs in Eighth Circuit appeal arguing for different transfer pricing methods

The IRS and Medtronic Inc. (Medtronic US) both have filed appellate briefs with the US Court of Appeals for the Eighth Circuit in the long-running *Medtronic, Inc. and Consolidated Subsidiaries v. Commissioner* (*Medtronic*) transfer pricing case. In the most recent Tax Court case, the court had applied an "unspecified method" to determine the royalty rate for a license agreement between Medtronic US and its Puerto Rican subsidiary. The IRS argued in its brief that the Comparable Profits Method (CPM) should have been used for the calculation, while Medtronic US argued that the Comparable Uncontrolled Transaction (CUT) method should have been used.

This case has important consequences not only for the long-standing dispute over transactional versus profit-based methods (e.g., CUT method versus CPM), but also for the application of the unspecified method, which taxpayers may have used due to reliance on the second Tax Court opinion.

Taxpayers should closely monitor the outcome of *Medtronic* and other transfer pricing cases currently working through the courts that deal with similar disputes over the selection of the best method.

IRS representative says corporations that failed to respond to transfer pricing compliance letters have been referred for possible examination

A senior IRS official confirmed that the IRS has received responses from most of the US-based subsidiaries of foreign-owned corporations that received letters from the IRS asking about their intercompany transaction pricing. Those that have not responded have been referred for possible examination.

The letters (Letters 6607 and 6608) have gone mostly to corporations that distribute goods in the United States, and in limited instances, to corporations that manufacture goods in the United States. These letters stem from the corporations' alleged use of certain transfer pricing strategies that the IRS may deem improper.

The IRS announced ([IR-2023-194]) in October 2023 that it planned to send letters to approximately 150 US-based subsidiaries. The IRS updated this number to 180 in January 2024.

The letters are the first transfer pricing enforcement initiative following enactment of the *Inflation Reduction Act*. In addition to taxpayers that did not respond to the compliance letters, taxpayers that responded by defending their transfer pricing also may be referred for examination if the IRS does not consider their explanation satisfactory.

OECD developments

G20 Finance Ministers, Central Bank Governors reiterate support for BEPS 2.0

G20 Finance Ministers and Central Bank Governors issued a communique on 26 July following their meeting in Rio de Janeiro, reiterating their support for the BEPS 2.0 project. The statement welcomed the major progress to implement Pillar Two and expressed support for "implementing the Global Anti-Base Erosion Rules as a common approach." The communique also called on Inclusive Framework members to finalize negotiations on a Pillar One package – specifically, a framework for Amount B, which would allow for the finalization and signing of the Multilateral Convention.

Inclusive Framework on BEPS finalizing MLC to implement Pillar One Amount A, Amount B consensus near

An OECD official in mid-July was quoted as saying the Inclusive Framework on BEPS is close to finalizing the text for the multilateral convention (MLC) to implement Amount A in Pillar One. The objective of the MLC is to create a coordinated agreement to reallocate taxing rights to market jurisdictions with respect to a portion of the profits of in-scope multinational enterprises in excess of 10% of their global revenues.

The official further said consensus has been reached on virtually all areas of an expanded Pillar One Amount B framework. Amount B is intended to simplify and streamline the application of the arm's-length principle to baseline marketing and distribution activities, with a particular focus on the needs of low-capacity countries (Amount B approach).

OECD releases sixth edition of Corporate Tax Statistics publication

The OECD on 11 July 2024 released the sixth edition of its annual Corporate Tax Statistics Report, along with an updated Corporate Tax Statistics Database. The Report provides an overview of corporate tax data across 160 countries and jurisdictions, covering statutory and effective tax rates, withholding taxes, tax treaties, corporate tax revenues, multinational enterprise international activities and aggregated country-by-country reporting (CbCR) data. The Report is accompanied by an updated set of FAQs on the anonymized and aggregated CbCR data.

The updated Database includes anonymized and aggregated CbCR statistics based on 2021 data. It covers 52 headquarters jurisdictions and up to 217 affiliate jurisdictions from 2016 to 2021. Further, the Database includes a new dataset on income-based tax incentives for research and development and innovation, as well as updated information on controlled foreign company (CFC) rules and interest limitation rules. Additionally, it includes information on 61 intellectual property regimes across 46 jurisdictions and provides withholding tax rate statistics for 144 jurisdictions.

OECD releases draft GloBE information Return XML Schema

The OECD in July 2024 released for public comment a BEPS 2.0 Draft User Guide for the GloBE Information Return XML Schema. It is designed to facilitate domestic Global Anti-Base Erosion (GloBE) information return (GIR) filings "and to be the technical format for exchanging GIR information between tax administrations." The GloBE Model Rules require an annual GIR filing that provides information on tax calculations made by a multinational entity group. Comments are due by 19 August.

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