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Recent Developments in International Taxation

United States

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Overview

The political landscape in the United States continues to limit legislative activity with regard to international taxation, particularly due to the fact that neither political party controls both chambers of Congress (the House of Representatives and the Senate) and the Presidency. Although there has been a dearth of legislative activity, there have been numerous noteworthy federal court decisions, and the US Department of the Treasury (the 'Treasury') and the Internal Revenue Service (IRS) have issued regulations and guidance relevant to international taxation. Below is a high-level overview of selected US developments relevant to international taxation since June 2023.

Legislation

No significant tax legislation has been enacted since June 2023.

Selected case law

Since June 2023, a number of important court cases have been decided on tax issues or non-tax issues that affect tax. The potential implications of these decisions will reverberate for decades.

Moore v United States

On 20 June 2024, the US Supreme Court sided with the government in *Moore v United States*, No 22- 800, in holding that the mandatory repatriation tax (MRT) under section 965 of the Internal Revenue Code of 1986, as amended (the 'IRC') is constitutional. The case is one of the most closely followed tax cases in many years and a holding against the government could have had a significant impact on the constitutionality of many tax provisions, including international tax provisions. The Court's ruling was narrowly tailored, avoiding the need to address whether income has a realisation requirement before it can be taxed.

The petitioners owned shares in a controlled foreign corporation (CFC) and paid tax on income earned by the CFC that had not been distributed to the petitioners. Accordingly, that income had not yet been subject to US tax. The MRT subjected the income to tax, which the petitioners paid and then sued for a refund. The petitioners claimed that the MRT was unconstitutional because: (1) the MRT violated the Direct Tax Clause of the Constitution (ie, they believed that the MRT was an unapportioned direct tax on their shares in the CFC; and (2) the MRT violated the Due Process Clause of the Fifth Amendment (ie, it applied retroactively to past income).

The District Court dismissed the suit and the US Court of Appeals for the Ninth Circuit affirmed the District Court. The Court of Appeals held that the MRT constitutes a tax on income within the meaning of the Constitution because the CFC earned income and the MRT assigned a pro rata share of such income to the petitioners. The Court of Appeals rejected the Due Process Clause argument and the petitioners sought a review in the US Supreme Court on the Direct Tax Clause.

The Court's decision, with seven justices in the majority and two dissenting, upheld the Court of Appeals decision that Congress has the power to tax either an entity or its shareholders or partners. In writing for the majority, Justice Brett M Kavanaugh stated that the holding is limited to taxing

shareholders on undistributed income realised by the entity and attributed to the shareholders when the entity has not been taxed.

Justice Kavanaugh wrote that, 'Congress has long taxed shareholders of an entity on the entity's undistributed income, and it did the same with the MRT. This Court has long upheld taxes of that kind, and we do the same today with the MRT.' He went on to state that, '[n]othing in this opinion should be read to authorise any hypothetical congressional effort to tax both an entity and its shareholders or partners on the same undistributed income realised by the entity. In such a scenario, the entity would not simply be a traditional passthrough'. The opinion avoided addressing the question of whether income needs to be realised before being subject to tax.

Loper Bright Enterprises v Raimondo and Relentless, Inc v Dept of Commerce

On 28 June 2024, in two non-tax cases with broad implications, *Loper Bright Enterprises v Raimondo* and *Relentless, Inc v Dept of Commerce*, Nos 22-452 and 22-1219, the US Supreme Court overturned a 40-year precedent that directed courts to give deference to regulatory interpretations of ambiguous statutes, as long as the regulators' interpretations were reasonable. Although the regulation at issue in the cases related to fishing boats and was not a tax regulation, the holding applies to all regulatory agencies, including the Treasury and IRS.

The ruling is a triumph for opponents of big government, overturning *Chevron v Natural Resources Defense Council*, a 1984 decision that administrations used in the legal support of new regulations to interpret unclear laws. The decision places more responsibility on Congress to draft appropriate laws and reins in agency regulators if they exceed their authority. Tax practitioners anticipate significant changes in tax law, an increase in litigation challenges to regulations and more informal guidance from agencies.

In writing for the majority, Chief Justice John Roberts stated, '*Chevron*'s presumption is misguided because agencies have no special competence in resolving statutory ambiguities. Courts do. The Framers [of the US Constitution] anticipated that courts would often confront statutory ambiguities and expected that courts would resolve them by exercising independent legal judgment.'

Corner Post Inc v Federal Reserve

On 1 July 2024, in another non-tax case with tax implications, *Corner Post Inc v Federal Reserve*, No 22-1008, the US Supreme Court reversed and remanded a 2022 Court of Appeals for the Eighth Circuit ruling regarding the date on which a right of action begins accruing for bringing Administrative Procedure Act facial claims against final agency rules under the general six-year statute of limitations on civil actions against the US pursuant to 28 USC section 2401(a). In a facial claim, the plaintiff's argument was that, for example, the agency did not provide proper notice, did not consider all comments in issuing a final rule or issued a final rule that was arbitrary and capricious.

The plaintiff appealed the Eighth Circuit's decision, which held that the limitation period for facial challenges commenced when a final rule was promulgated. The US Supreme Court disagreed, saying that the 'answer is straightforward'. Writing for the majority opinion, Justice Amy Coney Barrett, stated, '[a] claim accrues when the plaintiff has the right to assert it in court – and in the case of the [Administrative Procedure Act], that is when the plaintiff is injured by final agency action'.

The Court's decision in *Corner Post,* particularly in light of the Court's decision in *Loper Bright,* may significantly increase the ability of taxpayers to challenge existing Treasury rules and regulations, and any overturned regulations or rules would apply for all purposes and not only the plaintiff.

Liberty Global, Inc v United States

In one of the few cases in which the economic substance doctrine (ESD) has been applied, the US District Court for the District of Colorado in *Liberty Global, Inc v United States*, No 1:20-cv-03501 (D Colo Oct 31, 2023) (the 'LGI ESD case'), upheld the application of the ESD in the government's favour. The case is on appeal. On 8 November 2023, in a separate case for Liberty Global in the Tax Court on an issue of first impression, *Liberty Global Inc v Commissioner*, 161 TC No 10 (the 'LGI OFL case'), the Tax Court held for the IRS that the IRC section 904(f)(3) overall foreign loss ('OFL') recapture rule recharacterises only OFL recapture gain and does not apply to other gains.

In a prior decision in April 2022 for Liberty Global Inc (LGI), the District Court for the District of Colorado invalidated the temporary IRC section 245A regulations that would have prevented the application of the dividends received deduction (DRD) under IRC section 245A. The Court held that the regulations did not meet the Administrative Procedure Act's notice and comment requirement. Displeased with that holding, the government filed a different lawsuit asserting the application of the ESD and step transaction doctrine, giving rise to the LGI ESD case.

In the LGI ESD case, the taxpayer challenged the government's application of the ESD and step transaction doctrine to disregard an entity conversion involving a Belgian limited liability company (a disregarded entity (DRE) for US federal income tax purposes) into a Belgian *naamloze vennootschap/société anonyme* (a CFC for US federal income tax purposes), which is like converting a disregarded limited liability company (LLC) into a corporation. LGI treated the conversion as an IRC section 351 transaction with boot that created earnings and profits, which was not taxed as subpart F or global intangible low-taxed income. LGI claimed a DRD under IRC section 245A on the subsequent sale of the CFC, which was treated as a dividend.

LGI argued that the ESD is not relevant if a foreign entity converts to a corporation taxed as a CFC from an LLC that is treated as a DRE under Belgian law. The government argued that the transaction as a whole had no economic substance in creating non-taxable exploration and production (E&P).

In holding for the government, the Court cited legislative history supporting its determination that the ESD is relevant to LGI's issue. The Court then concluded that it could aggregate or disaggregate interrelated transactions to determine that the transaction to be evaluated was the conversion along with other relevant steps. Next, the Court analysed whether the transaction was exempt from the ESD and held that the transaction was not a basic business transaction to which the ESD was inapplicable. Finally, the Court applied the ESD test to conclude that it applied to LGI's transaction by determining that the non-tax consequences of the transaction were insufficient to meaningfully change LGI's position.

Last, the Court analysed both prongs of the ESD test to determine that the ESD applied to LGI's transaction. The Court determined that the non-tax consequences of the transaction were insufficient to meaningfully change LGI's position and held that the sale of the CFC yielded taxable gain instead of an IRC section 245A DRD.

Separately, the LGI OFL case in the Tax Court dealt with an OFL account balance of approximately $474m. LGI realised a gain on the sale of all of its stock in a Japanese CFC to an unaffiliated foreign corporation. LGI reported a portion of the gain as dividend income under IRC section 1248 and the remainder as foreign-source income under IRC section 904(f)(3), allowing LGI to claim foreign tax credits (FTCs) of $240m. The issue in dispute involved the implications of IRC section 904(f)(3) for LGI's gain beyond the amount needed to accomplish its OFL recapture.

According to the Court, IRC section 904(f)(3)(A) addresses only the gain necessary for the OFL recapture and it is inapplicable regarding whether any other income is recharacterised as foreign-source gain. The Court explained that a statute's silence does not create a new exclusion to determine the treatment under other IRC sections, and that IRC section 904(f)(3)(A) is not ambiguous.

The Court rejected LGI's claim that Treasury Regulation section 1.904(f)-2(d)(1) applies to allow the treatment of gain from the CFC stock sale as foreign source income and instead concluded that the regulation addresses solely the portion of gain necessary to recapture an OFL balance.

In conclusion, the Court held that the remaining gain is taxed under other IRC provisions, requiring the gain to be fully recognised under IRC section 1001, recharacterised in part under IRC section 1248, and treated as US-source income under IRC section 865. LGI was permitted to deduct its foreign taxes under IRC section 164(a)(3).

YA Global Investments LP v Commissioner

On 15 November 2023, the US Tax Court issued its opinion in *YA Global Investments LP v Commissioner,* a long-awaited decision that would perhaps clarify 'grey' areas of the tax law involving attribution of business activities to US agents, the status of financing activities constituting investing, trading and lending activities in the US, the definition of a 'dealer in securities' and related issues. While the Tax Court ruled in favour of the IRS, the ruling was mostly based on a set of unfortunate facts for the taxpayer and generally does not help clarify more nuanced factual scenarios.

YA Global Investments LP was a Cayman Islands partnership that acquired different types of interests in US companies. Yorkville Advisors LLC served as YA Global's investment manager and its general partner through an office in the US. Yorkville was compensated through a management fee based on a percentage of YA Global's assets and an incentive fee.

Yorkville and YA Global's management agreement appointed Yorkville as YA Global's fund manager and designated it as YA Global's agent and irrevocable attorney-in-fact with full power to buy, sell and otherwise deal in securities and related contracts for YA Global's account. YA Global had direct US and foreign partners and established YA Offshore Global Investments Ltd to serve as a corporate 'blocker' for non-US investors. YA Global had no employees and instead relied on Yorkville and its many employees.

Yorkville performed lending, investment and stock distribution activities pursuant to the management agreement. YA Global was either Yorkville's only client or its only significant client. YA Global's primary activity was providing funding to portfolio companies.

Chief Counsel Advice Memorandum 201501013 ('CCA'), issued on 2 January 2015, analysed whether certain lending and stock distribution activities constituted a trade or business within the US.

The CCA concluded that the fund (later confirmed in the opinion as YA Global) was engaged in a US trade or business because of the nature and extent of its agent's (Yorkville's) lending and underwriting activities and the conclusion that the agent performed those activities as the fund's agent.

The Tax Court concluded that Yorkville served as YA Global's agent because, for example, it performed minimal activities outside of those performed on YA Global's behalf and had extensive authority under the management agreement. In analysing the distinction between a service provider and an agent, the Tax Court put significant weight on YA Global's right to issue interim instructions to Yorkville under the management agreement.

On the issue regarding whether YA Global's activities, including those conducted by Yorkville on its behalf, constituted a US trade or business, the Tax Court stated that YA Global was involved in a trade or business if its activities were sufficiently regular and continuous, and no specific exception applied. The Court concluded that the activities were sufficiently regular and continuous.

The Tax Court also found that the fees indicated that something beyond mere investment was occurring and pointed to Yorkville's discretion in whether to remit fees to YS Global and Yorkville's transactional role going beyond that of an investor. Finally, it determined that YA Global did not qualify for the securities trading safe harbour.

Christensen v United States

In *Christensen v United States*, No 20-935T (Fed Cl Sept 13, 2023), the Court of Federal Claims held that a US couple living in France could claim an FTC against the net investment income tax (NIIT) under the US-France Income Tax Treaty (as amended, the 'US-France Treaty'). The decision came as a bit of a surprise, especially on the heels of the Tax Court's contradictory conclusion under the US-France Treaty in *Toulouse v Commissioner*, 157 TC 49 (2021).

Paragraphs (1) and (2) of Article 24 of the US-France Treaty implement the so-called 'three-bite rule', a provision in many US income tax treaties to govern FTCs against French and US taxes on the income of US citizens who are French residents. Each bite represents a tax by either country: first, US tax authorised by the Treaty on certain US source income of a French resident; second, French tax on income earned by a French resident; and third, US tax on worldwide income imposed based on citizenship, as preserved by the saving clause. Generally, no FTC is meant to apply against the first-bite US tax. When France takes the second bite, it allows an FTC for the first-bite US tax. Then, on the third bite, the US allows an FTC for the second-bite French tax, facilitated by the resourcing rule in Article 24(2)(b)(ii) for purposes of computing the section 904 limitation.

The Court observed that IRC sections 27 and 901(a) expressly restrict the application of FTCs to taxes imposed by chapter 1 of the IRC. Thus, 'by their terms', these IRC sections do not permit an FTC against the NIIT imposed by IRC section 1411, which is in chapter 2A of the IRC. The taxpayers acknowledged that they would not be entitled to offset NIIT based solely on the IRC, but maintained that the US-France Treaty nonetheless provided relief.

The Court invoked a 'responsibility to read the Treaty in a manner "consistent with the shared expectations of the contracting parties"' (*Lozano v Montoya Alvarez*, 572 US 1, 12 (2014)). The Court also embraced the principle of the 'liberal construction' of treaties, as explained in *United States v Stuart*: 'where a provision of a treaty fairly admits of two constructions, one restricting, the other enlarging,

rights that may be claimed under it, the more liberal interpretation is to be preferred' (489 US 353, 368 (1989) (quoting *Bacardi Corp of Am v Domenech*, 311 US 150, 163 (1940)).

The Court agreed with the government's reading of paragraph (a) of Article 24(2) of the US-France Treaty, holding that the paragraph's reference to domestic law 'provisions' and 'limitations' precludes an FTC against NIIT because the tax is not imposed by chapter 1 of the IRC. However, the Court sided with the taxpayers' view of paragraph (b) of Article 24(2), holding that the paragraph could permit an FTC against the NIIT. Critical to the Court's view was Article 24(2)(b)'s plain text, which made no reference to domestic law constraints like paragraph (a).

Farhy v Commissioner

In *Farhy v Commissioner, No* 23-1179 (DC Cir 2024), on appeal from the US Tax Court, the Court of Appeals for the District of Columbia Circuit ruled that the IRS can assess penalties for wilful failure to disclose an interest in a foreign corporation. The scope of the decision did not address whether the IRS must sue to enforce several other penalties in the IRC.

The case involved a resident alien who failed to file returns disclosing his interests in Belizean corporations and the IRS's assertion of penalties under IRC section 6038(b) of almost $500,000. In 2022, the Tax Court ruled that the IRS had to file suit to impose the failure-to-report penalties under IRC section 6038(b) and the IRS appealed.

On appeal, the IRS argued that the default under IRC section 6201(a) is that all penalties are assessable unless the IRC specifically provides otherwise. The taxpayer argued that IRC section 6201 created a far narrower list of assessable penalties. The Court focused on IRC section 6038 and concluded that the text, structure and function of that provision implied that IRC section 6038(b) penalties are assessable.

After oral argument in *Farhy,* but before the Court issued its opinion, it issued its opinion in another IRC section 6038(b) case, *Mukhi v Commissioner,* 162 TC No 8 (2024), holding in the taxpayer's favour. The *Mukhi* case is appealable to the Eighth Circuit, and therefore, the decision in the *Farhy* case would not be binding precedent. Going forward, the Tax Court must apply the *Farhy* case as precedent in cases appealable to the DC Circuit.

National Small Business United v Yellen

The Corporate Transparency Act (CTA), enacted to address illicit finance, requires certain companies doing business in the US to report ownership information. Among other things, the CTA requires corporations, limited liability companies and similar entities to disclose information about beneficial owners to the Treasury's Financial Crimes Enforcement Network, which can then release such information to government authorities and financial institutions. Under the CTA, more than 30 million reporting entities will exist in 2024, growing by approximately five million per year over the next decade.

In *National Small Business United v Yellen,* Case No 5:22-cv-1448-LCB (ND Ala 2024), taxpayers challenged the constitutionality of the CTA on the grounds that the beneficial ownership reporting regime violates principles of federalism and forces significant costs onto states. The US District Court for the Northern District of Alabama granted summary judgment to the taxpayers on 1 March 2024. The Court held that the CTA was an improper exercise of congressional authority under the commerce clause, Congress's taxing power or Congress's power to oversee foreign affairs and national security. The Court focused on

the extent to which the states historically had exclusive governance over incorporation. The government has appealed the decision to the US Court of Appeals for the Eleventh Circuit.

Selected regulations

Tax Credit Regulations under the Inflation Reduction Act of 2022 (the 'IRA')

In an effort to publish voluminous guidance relating to various tax credits under the IRA, the Treasury and IRS published numerous forms of guidance. Set forth below is a list of the proposed and final regulations issued. It is important to note that other forms of guidance (eg, IRS notices, announcements, revenue procedures and frequently asked questions (FAQs)) are not addressed in this report but can be found at **www.irs.gov/inflation- reduction-act-of-2022**:

- on 10 August 2023, final regulations on the Low-Income Communities Bonus Credit for clean energy investments in low-income communities;
- on 3 March 2024, final regulations regarding the qualification for clean energy tax credits for entities lacking federal tax liability, such as tribes and non-profit entities;
- on 25 April 2024, final regulations on the transfer of clean energy tax credits;
- on 3 May 2024, final regulations on the critical mineral requirements for electric vehicle (EV) tax credits; and
- on 18 June 2024, final regulations on the prevailing wage and apprenticeship requirements for various tax incentives.

CTA Regulations

On 1 January 2024, the Treasury's Financial Crimes Enforcement Network ('FinCEN') began accepting beneficial ownership information reports under the CTA, enacted in 2021, to address illicit finance. The CTA requires certain companies doing business in the US to report ownership information. Companies that were created or registered to do business before 1 January 2024 must file by 1 January 2025, and companies created or registered in 2024 must file within 90 days after actual or public notice of the effective date for the company's creation or registration. Please also see the discussion above regarding the pending case challenging the constitutionality of the CTA.

Foreign Investment in Real Property Tax Act (FIRPTA) Regulations

The Treasury and IRS issued final FIRPTA regulations on 24 April 2024, which include a look-through rule to determine whether a real estate investment trust or other qualified investment entity (QIE) is domestically controlled, and if so, an interest in the QIE is not treated as a US real property interest, avoiding tax on the sale of the interest under FIRPTA.

The look-through rule modifies the controversial approach in the 2022 proposed regulations, which looked through to the shareholders of non-public domestic C corporations in which foreign persons held 25 per cent of stock by value. The controversy revolved around the use of a domestic C corporation as a 'blocker' on inbound investment.

The inclusion of a ten-year transition rule exempts existing structures from the look-through rule if the QIE meets certain requirements. The transition rule ceases to apply in certain circumstances based on changes

to the composition of the fair market value of new US real property interests and those held on 24 April 2024 and changes to the ownership of the QIE.

The regulations also treat qualified foreign pension funds, which are not subject to tax under FIRPTA, as foreign persons for the purpose of determining whether a QIE is domestically controlled. The preamble states that treating these funds as foreign does not conflict with the statute because 'the term "nonresident alien individuals or foreign corporations" in section 897(l) (introduced only in the 2018 technical correction) differs from "foreign persons" in section 897(h)(4)(B), and the purposes of the two provisions also differ'.

With regard to a regulated investment company (RIC), the regulations provide that a RIC is not subject to the look-through rule if it is not a QIE and meets certain additional requirements.

Further, unless a QIE has actual knowledge that a person is neither a US person nor foreign-controlled, the final regulations provide that a person holding less than five per cent of US publicly traded stock of a QIE at all times during the testing period generally is treated as a US person in determining whether the QIE is domestically controlled. There is also guidance for a QIE to voluntarily certify that it is domestically controlled, alleviating withholding on the purchase of stock in the QIE from a foreign seller.

Excise tax for stock repurchases

The IRA imposed a new excise tax under IRC section 4501 on stock repurchases after 31 December 2022 equal to one per cent of the aggregate fair market value of stock that certain corporations repurchased during the taxable year, with certain adjustments.

The proposed regulations, issued on 9 April 2024, would affect publicly traded domestic corporations that repurchase their stock or whose affiliates acquire the stock. Certain publicly traded foreign corporations that repurchase their stock or whose stock is acquired by certain affiliates would also be affected. These regulations follow Notice 2023-02, published on 17 January 2023, which provided initial guidance on the application of the stock repurchase excise tax. On 28 June 2024, the Treasury and IRS issued final regulations regarding how the excise tax should be reported and paid.

The proposed regulations would include a statutory netting rule to reduce the aggregate fair market value of stock that a taxpayer repurchased during a taxable year by the aggregate fair market value of stock that the taxpayer issued during the taxable year. Additionally, the proposed regulations would implement the statutory *de minimis* exception precluding the application of the excise tax if the aggregate fair market value of the stock repurchased by the taxpayer during the taxable year does not exceed $1m.

The proposed regulations modify the so-called funding rule announced in Notice 2023-02 for determining whether an affiliate of a foreign corporation should be treated as funding a stock repurchase by replacing a 'per se' rule with a rebuttable presumption. The funding rule is a backstop to the general rule, under which if an applicable specified affiliate of an applicable foreign corporation acquires the stock of the applicable foreign corporation from a person that is not the applicable foreign corporation or another specified affiliate of the applicable foreign corporation, the applicable specified affiliate is treated as a covered corporation with regard to the acquisition, and the acquisition is treated as a repurchase of stock of a covered corporation by the covered corporation.

Under the proposed regulations, an affiliate of a foreign corporation is treated as acquiring stock of that corporation if the affiliate funds by any means, directly or indirectly, a repurchase of stock with a principal purpose of avoiding the excise tax. A principal purpose is presumed to exist if the affiliate funds by any means, directly or indirectly, a downstream relevant entity, and the funding occurs within two years of a covered purchase by or on behalf of the downstream relevant entity. The presumption may be rebutted only if facts and circumstances clearly establish that there was not such a principal purpose. Notice 2023-02 applied a per se rule rather than a rebuttable presumption.

Partnership regulations

The Treasury and IRS issued proposed regulations on 24 November 2023, which would modify the rules regarding whether persons are treated as related for purposes of disallowing or deferring deductions for losses and expenses in certain transactions with partnerships.

In applying various rules, the proposed regulations treat partnerships as entities rather than aggregates. This treatment would apply for the loss disallowance rules, the gain recharacterisation rules, and the matching rules of IRC sections 267 and 707(b), with the intention to conform existing regulations to statutory changes enacted in the 1980s.

Digital asset regulations

On 28 June 2024, the Treasury and IRS issued final regulations on digital assets, including broker information reporting, the determination of amount realised and basis, and backup withholding for certain digital asset sales and exchanges. The final regulations adopt the proposed regulations issued in August 2023, with amendments.

Among other things, the regulations define a digital asset as a digital representation of value that is recorded on a cryptographically secured distributed ledger or similar technology, regardless of whether the individual transaction involving that digital asset is recorded on the cryptographically secured distributed ledger. In addition, the regulations state that a digital asset does not include cash in digital form.

Digital assets are intended to include all types of digital assets, including so-called stablecoins that are designed to have a stable value relative to another asset or assets, and non-fungible tokens without regard to the nature of the underlying asset. Types of virtual assets that exist only in a closed system and cannot be sold or exchanged outside that system for fiat currency are not included as digital assets.

Foreign trust proposed regulations

On 8 May 2024, the Treasury and IRS published proposed regulations on information reporting of transactions with foreign trusts, receipt of large foreign gifts, loans from foreign trusts and uses of foreign trust property. The proposed regulations would also amend the rules governing foreign trusts with one or more US beneficiaries and would apply to US persons who own or transact with foreign trusts, or receive large gifts or bequests from foreign persons.

Other guidance

FTC notices

The IRS put into abeyance large portions of controversial FTC regulations that were finalised within the past two years. Under Notice 2023-55, released on 21 July 2023, taxpayers can choose to apply parts of the prior final regulations defining what constitutes a creditable foreign income tax for US purposes.

The new regulations narrowed the scope of creditable taxes by, for example, imposing 'attribution rules' that made taxes uncreditable if they did not closely parallel the nexus rules followed under the US federal income tax regime. The IRS is considering proposing amendments to those regulations, the notice says.

Taxpayers have the option to apply the temporary relief for foreign taxes paid in tax years beginning on or after 28 December 2021 (the applicability date for the new final FTC regulations) and ending on or before 31 December 2023. The Treasury and IRS are considering whether, and under what conditions, to provide additional temporary relief beyond that period.

Under the notice, taxpayers may choose to apply the previous version of Treasury Regulation section 1.901 2(a) and (b), with one modification that, the notice says, renders digital services taxes uncreditable. In addition, the notice allows taxpayers to apply existing Treasury Regulation section 1.903-1 (governing creditability of taxes in lieu of income taxes) without the requirement for source-based attribution and the requirement that the tested tax be in lieu of a net income tax that meets the attribution requirement. Taxpayers choosing to apply the temporary relief must apply it to all foreign taxes paid, including taxes paid by CFCs, during the relief years (2022 and 2023, generally).

On 11 December 2023, in Notice 2023-80, the Treasury and IRS announced that it planned to issue proposed regulations regarding the application of FTC and dual consolidated loss rules to certain top-up taxes. Among other things, the proposed regulations would disallow FTCs for taxes under the OECD's Pillar Two's income inclusion rule imposed on a US taxpayer's wholly owned subsidiary.

CFC income tax under the Corporate Alternative Minimum Tax (CAMT)

On 15 December 2023, the IRS issued guidance in Notice 2024-10 regarding the concern that a CFC's income could be taxed twice under the CAMT: (1) when the CFC earns the income; and (2) when the CFC's income is distributed to shareholders as a dividend. The proposed rule would provide that a CFC's income generally would be taxed under the CAMT only when earned by the CFC and not when distributed as a dividend to shareholders. The proposed rule would also modify prior guidance for consolidated groups to clarify that tax consolidated groups were not allowed to use their consolidated federal income tax returns to calculate their applicable financial statement income.

IRS enforcement

In IR 2024-09, the IRS announced that it deployed its IRA funding to collect more than $482m by focusing on wealthy taxpayers, and that it is using additional funds in its enforcement efforts against complex partnerships and incorrect transfer pricing. For example, the IRS is using artificial intelligence to buttress its enforcement efforts, including machine learning technology to identify potential compliance risks in partnership tax, general income tax, and accounting and international tax. For transfer pricing, the IRS announced that it sent compliance alerts to more than 180 corporations to help enforce transfer

pricing and incentivise self-correction.

Modifications to IRC section 174 guidance

On 23 December 2023, the IRS released Notice 2024-12, which provides guidance on IRC section 174 in the context of contract R&D providers. In general, the guidance indicates that a taxpayer will not be required to capitalise R&D costs if the taxpayer does not bear financial risk under the contract with the research recipient. Even if a contract R&D provider receives rights in the associated intangible property, there is no requirement to capitalise R&D costs as long as such rights are: (1) separately bargained for or (2) acquired solely to allow for the performance of contract R&D for that service recipient. The guidance indicates that rights are separately bargained for if payment for such rights emanates from amounts other than the amounts paid for the contract R&D.

'Implicit support' and intercompany lending

On 19 December 2023, the IRS released AM 2023-008, a form of generic legal advice memorandum (GLAM), which concluded that the IRS may consider related-party group membership 'implicit support' to calculate the arm's length interest rate for intercompany lending under IRC section 482. The GLAM reasoned that, because an unrelated lender may consider group membership in establishing financing terms, the IRS may do so too. This issue is the subject of litigation in the US, is on the IRS priority guidance plan and has been the focus of cases outside the US, including *Canada v General Electric Capital Canada Inc* in Canada and *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* in Australia. The reasoning in the GLAM has garnered considerable debate in the US international tax community.

The GLAM provides that benchmarking for the arm's length interest rate to be charged by the lender to the borrower based on the borrower's credit rating from standalone and group credit profiles may take into account: (1) the relationship between the borrower's businesses and assets to those of the overall multinational group; and (2) the likelihood that another entity within the multinational group would provide financial support to the borrower in the event that the borrower encountered financial difficulty (eg, contributing equity and forgiving debt) absent an explicit guarantee or other formal commitment.

The GLAM discusses the 'realistic alternatives principle', including the application from the borrower's perspective, but also concludes that it is not appropriate to apply that principle from the lender's perspective if the lender is also the borrower's foreign parent. It also states that, absent any explicit support, such as a guarantee, implicit support is a passive association benefit for which the borrower is not obligated to compensate any group member.

Previously taxed earnings and profits basis notice

Notice 2024-16, released on 29 December 2023, indicates that the IRS plans to issue proposed regulations regarding previously taxed earnings and profits (PTEP) and IRC section 961 basis issues relating to inbound transactions for which double taxation may arise, including restructuring transactions due to the OECD's Pillar Two's global minimum tax. Such inbound transactions include a domestic corporation's acquisition of a CFC's stock in an IRC section 332 liquidation or an IRC section 368(a)(1) asset

reorganisation. Subject to certain conditions, taxpayers can rely on the rules described in the notice for transactions completed on or before the date proposed regulations are published.

Digital asset reporting

The IRS extended IRC section 6050I digital asset reporting requirements in IRS Announcement 2024-04. Under IRC section 6050I(a), a person engaged in a trade or business who receives cash, including digital assets, in excess of $10,000 in one transaction (or two or more related transactions) must file an information return reporting receipt. The return is required to be filed on Form 8300 within 15 days of receipt and an annual written statement must be provided to each payer.

R&D capitalisation

In Notice 2023-63, the IRS stated that R&D costs that must be capitalised under IRC section 174 will continue to be subject to amortisation, even if the underlying property is disposed of during the amortisation period. This position is based on the IRS's interpretation of IRC section 174(d), which states that 'no deduction shall be allowed' on a disposition, abandonment or retirement of the property during the amortisation period. The notice also discusses contract research amortisation provisions, the receipt of cost-sharing transaction payments, the definition of software development costs subject to capitalisation under IRC section 174(c)(3) and costs allocable to long-term contracts.

CAMT

In Notice 2023-64, the IRS provided additional guidance on the application of the CAMT. The notice includes rules on numerous elements of the CAMT, including determining the applicable financial statement income, rules applicable to consolidated groups, the treatment of US shareholders of CFCs, financial statement net operating loss carry-overs, the definition of an 'applicable corporation' and the CAMT FTC.

Repatriated intangible property under section 367(d)

The IRS ruled that repatriations of intangible property in tax-free 'F' reorganisations under IRC section 368(a)(1)(F) (ie, change of identity, form or place of organisation) resulted in the exclusion of the IRC section 367(d) deemed annual royalty payment from the US parent's gross income under the consolidated return regulations, and in particular Treasury Regulation section 1.1502-13(c)(6)(ii)(D). See LTR 202334014 and LTR 202335001, released 25 August 2023.

Foreign Account Tax Compliance Act (FATCA) penalty waiver

For 2024, the IRS extended a FATCA penalty waiver in place since 2017. The waiver provides that withholding agents are not subject to penalties, interest or additions to tax for failing to withhold and report, by 15 March of the subsequent year, a dividend-equivalent payment made on a derivative referencing a partnership. The waiver requires that the withholding agent must withhold and report on Form 1042 and Form 1042-S by 15 September 2024 for the 2023 calendar year or 15 September 2025 for the 2024 calendar year.

Treaty developments

US–Hungary Treaty

Effective 8 January 2023, the US terminated its tax treaty with Hungary in light of Hungary's decision to block the European Union's implementation of the 15 per cent global minimum tax. Announcement 2024-05 states that, for tax withheld at source and for all other taxes, the US–Hungary Treaty ceased to have effect on amounts paid or credited or for tax periods beginning after 31 December 2023.

US–Chile Treaty

On 19 December 2023, the US–Chile Tax Treaty entered into force. The Treaty is consistent with the 2006 US model tax treaty and is the first treaty between the two countries.

US–Russia Treaty

On 17 June 2024, the Treasury announced that it formally notified the Russian Federation of confirmation to suspend the operation of the US–Russia Tax Treaty by mutual agreement. The suspension is effective with regard to taxes withheld at source and for other taxes beginning on 16 August 2024 and will remain in place until otherwise decided by the US and Russia. The Treasury's action was in response to the Russian Federation's suspension notification on 8 August 2023.

OECD Pillars One and Two

Although US Treasury Secretary Janet Yellen announced that the US signed on to the OECD Inclusive Framework's 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy' (the 'IF Statement') dated 8 October 2021, US Congress has not passed legislation to enact the provisions of the IF Statement. It seems unlikely that such legislation would be proposed prior to 2025 (ie, when the next Congress is seated after the elections on 5 November 2024).

On 21 October 2021, the US, Austria, France, Italy, Spain and the United Kingdom (the 'Participants') reached a political compromise set forth in the Joint Statement from the United States, Austria, France, Italy, Spain, and the United Kingdom Regarding a Compromise on a Transitional Approach to Existing Unilateral Measures During the Interim Period Before Pillar I is in Effect (the '21 October Joint Statement'). As a Participant, the US committed to remain in close contact to ensure a common understanding of commitments under the 21 October Joint Statement. On 18 December 2023, the OECD Inclusive Framework called for finalising the text of the Pillar One multilateral convention by the end of March 2024. With the delays in the Pillar One multilateral convention, the Participants extended the political compromise set forth in the 21 October Joint Statement until 30 June 2024.

On 7 March 2024, the Tax Subcommittee of the US House of Representatives, Committee on Ways and Means, held a hearing on Pillar One. Previously, the same Subcommittee held a hearing on 19 July 2023 on both Pillar One and Pillar Two. The hearing focused on concerns with regard to Pillar I, how to address digital services taxes, the shortcomings of Pillar One's Amount B simplification and Pillar One's Amount A computations and implications. Additional information on the hearing, including a recording of the hearing, is available at the following link: **https://waysandmeans.house.gov/event/tax-subcommittee-hearing-on-oecd-pillar- 1-ensuring-the-biden-administration-puts-americans-first/**.