The Corporate Tax Planning Law Review

Fourth Edition

Editors
Jodi J Schwartz and Swift S O Edgar

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THE CORPORATE TAX PLANNING LAW REVIEW

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PREFACE

We are pleased to present the fourth edition of *The Corporate Tax Planning Review*. This volume contains 19 chapters, each devoted to a different country and each providing expert analysis by leading practitioners of the most important aspects of tax planning for multinational corporate groups in that country, with a particular focus on recent developments.

The jurisdictions represented in this volume are diverse and include established major economies (e.g., the United States, Germany and Korea), EU countries (both those that have become popular destinations for new business organisations and those where multinationals tend to form entities to facilitate local operations or investments), the city-state of Singapore and several nations in the Global South (Colombia, Malaysia and more). Echoing this geographical variety, *The Corporate Tax Planning Review* describes tax developments worldwide that are a response to different challenges in different places. At the same time, many countries share goals of preventing jurisdiction shopping, protecting against erosion of the tax base, promoting local investment and raising revenue. These complex and at times conflicting goals present opportunities for the well advised and traps for the unwary.

Although each chapter discusses issues at the cutting edge of tax law, the authors have contextualised their analyses with sufficient background information to make this volume accessible and useful to generalists and to tax practitioners outside each particular jurisdiction. Although *The Corporate Tax Planning Review* is by its nature an abbreviated overview, we hope it will at least serve as a workable compass to in-house counsel and outside advisers as they attempt to navigate their clients through the unsteady and sometimes uncharted waters of contemporary corporate tax planning.

We are extremely grateful to the contributors who have assiduously distilled a wealth of expertise to create this volume and to Isabelle Gray, Nick Barette and Adam Myers at Law Business Research Ltd for their editorial acumen and dedication to this project.

Jodi J Schwartz
Swift S O Edgar
Wachtell, Lipton, Rosen & Katz
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Chapter 19

UNITED STATES

Jodi J Schwartz and Swift S O Edgar[1]

I INTRODUCTION

For decades, the US federal income taxation of corporations coupled a high statutory rate imposed on worldwide income with the opportunity for essentially permanent deferral of offshore earnings. This combination of the incentive and means for keeping corporate earnings outside the United States led to controversial tax and business strategies by multinational enterprises with significant US operations, such as corporate 'inversions', intercompany borrowings intended to generate deductible interest payments in the United States and corresponding offshore income, extraterritorial ownership of intellectual property and retention of cash abroad. In 2017, legislation popularly known as the Tax Cuts and Jobs Act (TCJA) re-examined these aspects of the tax code and, among other changes, cut the corporate income tax rate from 35 per cent to 21 per cent, broadened the kinds of offshore income that may be subject to current taxation in the United States, subjected untaxed corporate earnings to a one-time 'repatriation' tax and enacted a limited 'participation exemption' regime applicable to the foreign source portion of dividends from corporate subsidiaries.

Although the TCJA is a familiar part of the US tax landscape, expiration dates (or 'sunset provisions') built into the law to comply with procedural rules of the US Senate requiring the TCJA to be revenue-neutral over 10 years and proposals for reform leave significant areas of uncertainty. Taxpayers wonder, as the sunset provisions continue their journey towards the horizon, whether Congress will pass legislation extending daylight hours. More significantly, the TCJA broadly reflected the policy preferences of the Republican Party, which controlled both houses of Congress and the presidency when the act was passed. Since then, the political winds have shifted: President Biden is a Democrat, and his party holds slim majorities in the House of Representatives and the Senate. Any tax legislation passed in the near term will reflect Democratic priorities and might reverse some of the TCJA's innovations. This chapter focuses on the law as it is now but notes relevant areas of potential revision, particularly under the proposed Build Back Better Act. Although key legislators have indicated unwillingness to support the Build Back Better Act in its current form, it is likely to serve as a blueprint, or at least a conceptual sketch, for any future legislation that might be passed while President Biden remains in office.

Despite the significance of the TCJA and recent proposals for reform, the US tax code has shown significant continuity over the past three and a half decades, especially as it relates to domestic corporations. The law is still the Internal Revenue Code of 1986, as amended (the Code), and the historical structure of US federal corporate income tax remains

1 Jodi J Schwartz is a partner and Swift S O Edgar is an associate at Wachtell, Lipton, Rosen & Katz.

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intact: tax[2] is imposed on corporations when net income is 'realised' and 'recognised' for tax purposes, and again at the shareholder level when corporate earnings are distributed. The rules for recognition and non-recognition of income remain fundamentally consistent with prior law, despite some revisions. Thus, tax directors of multinational enterprises with US operations or organisations need to retain their mastery over the tax code, which was last overhauled in 1986, while grappling with the challenges and opportunities presented by the TCJA and keeping an eye on developments in Washington that might yet again upend, or at least disturb, the tax plans laid in response to current law.

II LOCAL DEVELOPMENTS

i Entity selection and business operations

The United States generally imposes tax on the net worldwide income of individual US citizens and permanent residents as well as corporations organised in the United States or any of its political subdivisions.[3] The Code generally allows taxpayers to elect the legal form through which they earn income. This chapter focuses on 'C corporations'[4] – namely entities subject to taxation under Subchapter C of the Code, the required classification for business organisations incorporated in a political subdivision of the United States and certain non-US entities listed in Internal Revenue Service (IRS) regulations and a classification available by election to other entity types (general partnerships, limited partnerships, limited liability companies and most non-US entities, etc.).[5] The earnings of corporations are generally subject to two levels of tax, whereas partnerships generally pass their income through to their owners and in accordance with the owners' agreement (subject to complex tax rules).[6] Finally, disregarded entities are ignored for tax purposes.[7]

The TCJA affected taxpayers' most fundamental business choices in a few ways. Notably, it limited the deductibility of interest payments, changing the calculus of whether to capitalise an entity with debt or equity, and it added deduction available to non-corporate owners of businesses other than certain service professions.[8]

Interest deduction limitations: Section 163(j)

The deductibility of interest paid or accrued by a business is limited to interest expense that does not exceed 30 per cent (50 per cent for taxable years beginning in 2019 or 2020, under legislation enacted in response to the covid-19 pandemic)[9] of a business's 'adjusted taxable

2 Unless otherwise specified, in this chapter, 'tax' refers to US federal income tax, 'Section' references are to sections of the Code and 'Treasury Regulations Section' references are to the Treasury Regulations promulgated under the Code.

3 See Sections 1 and 11.

4 C corporations are referred to for the sake of simplicity as 'corporations'.

5 See Treasury Regulations Section 301.7701-3.

6 Sections 701ff.

7 Treasury Regulations Section 301.7701-3. The taxation of real estate investment trusts (REITs), regulated investment companies, 'S corporations', and other entities that share some features of corporations and some of partnerships or disregarded entities is beyond the scope of this chapter.

8 The TCJA also provided a tax incentive for licensing US-owned intellectual property overseas; however, it is likely that this change is more relevant to multinational groups than to businesses run through a single entity, and, accordingly, it is discussed in this chapter in Section II.ii under the heading 'FDII'.

9 Coronavirus Aid, Relief, and Economic Security Act, H.R. 748, Section 2306(a).

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income' – generally earnings before income tax, depreciation and amortisation (EBITDA) for tax years beginning before 1 January 2022 – and earnings before income taxes thereafter.[10] The limitation does not apply to interest allocable to the trade or business of performing services as an employee, electing real property or farming businesses, or certain utilities.[11] Although some legislators have proposed retaining EBITDA as the baseline for measuring allowable interest expense, at the time of writing, the prospects for passage of such an extender are uncertain.

In September 2020, the IRS finalised regulations clarifying several key points under Section 163(j). Most significantly, the regulations broadly define 'interest', which is not defined in the statute, to include amounts that are typically associated with that term, such as amounts paid for the use of money under the terms of a debt instrument, and amounts that constitute interest under US federal income tax law, such as original issue discount.[12] In addition, the regulations treat certain other amounts as adjustments to interest income, including amounts paid in respect of certain swaps and premium included by a debt issuer, and they include an anti-abuse catch-all treating deductible losses or expenses incurred to secure the use of funds as interest.[13]

Additional deduction for non-service income earned through a sole proprietorship or flow-through entity

As a result of the TCJA, C corporations are generally subject to a lower rate of tax than individual US taxpayers. Accordingly, depending on liquidity concerns and anticipated rate of return on investment, except in the case of corporations that pay substantial dividends, it might be preferable for individual shareholders to hold their investments in corporate form and to defer shareholder-level tax. However, the TCJA added Section 199A to the Code, complicating this calculus. Under Section 199A, non-corporate taxpayers (including shareholders of S corporations) are entitled to a deduction of up to 20 per cent of the taxpayer's taxable income. This deduction, which is applied at the sole proprietor, partner, real estate investment trust or S corporation shareholder level, is eliminated in respect of income derived from a 'specified service trade or business' (SSTB) for single taxpayers with income in excess of US$157,000 or married taxpayers filing jointly with income in excess of US$315,000, in each case, indexed for inflation.[14]

An SSTB is any trade or business (1) involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services or brokerage services; (2) where the principal asset of the trade or business is the reputation or skill of one or more of its employees or owners; or (3) involving the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests or commodities.[15] Section 199A is not obviously cohesive. Several of the enumerated professions are service professions, such as law and accounting,

10 Section 163(j)(8)(A).
11 Section 163(j)(7)(A).
12 Treasury Regulations Section 1.163(j)-1(b)(22)(i).
13 Treasury Regulations Section 1.163(j)-1(b)(22)(iii) and (iv).
14 In respect of income derived from a business that is not an SSTB, other than REIT dividends and publicly traded partnership income, the deduction is subject to a complex limitation system and may be eliminated if the business does not pay employee compensation.
15 Section 199A(d)(2).

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but other archetypal service professions (e.g., engineering and architecture) are excluded by the statute,[16] and trading or dealing in securities does not necessarily involve the provision of services (except by statutory definition). Moreover, the statute does not distinguish between active and passive owners of an SSTB.

Regulations under Section 199A provide several clarifications to the law, including a *de minimis* exception providing that a trade or business with US$25 million or less of gross receipts in a taxable year will not be treated as an SSTB if less than 10 per cent of the receipts is attributable to the performance of services in an SSTB (5 per cent in the case of a trade or business with gross receipts of more than US$25 million for a taxable year).[17] This exception has a 'cliff effect': if a trade or business with gross receipts of greater than US$25 million in a taxable year derives 5.001 per cent of its income from an SSTB, it is ineligible for the Section 199A deduction; accordingly, the availability of the deduction might vary from year to year based on a business's revenue streams.

Section 199A provides an attractive tax benefit to many taxpayers willing to forego the benefits of deferral of taxation at the level of an owner, and accordingly must be considered when taxpayers elect the form of entity through which they will hold a business. President Biden's proposal to increase the corporate tax rate to 28 per cent and to tax capital gains and dividends at ordinary income rates for taxpayers with incomes in excess of US$1 million would make the Section 199A deduction even more valuable, particularly for those in the highest income brackets.

ii Common ownership: group structures and intercompany transactions

The structure of the tax code as applied to purely domestic groups of corporations was largely unaffected by the TCJA, and there have been no notable recent proposals for change. Under Section 1501 of the Code, an 'affiliated group' of US corporations may file a consolidated tax return. Very generally speaking, affiliated corporations that file a consolidated return are taxed as one taxpayer until a corporation leaves the group, at which point gain or loss from prior intercompany transactions that was deferred during consolidation generally must be recognised.[18] In addition, a US corporation may deduct 100 per cent of the dividend income received from a member of its affiliated group, and 50 per cent of the dividend income from other domestic corporations, provided that the required holding period is satisfied.[19]

Non-US corporations may not be members of a US consolidated group, and prior to the enactment of the TCJA, a deduction in respect of dividends received from a foreign corporate subsidiary was generally available only in respect of the US source portion of the dividends.[20] Through Section 245A, the TCJA removed this incentive to keep cash outside the United States and established a partial participation exemption: the foreign source portion of dividends received from a 10 per cent-owned foreign subsidiary is now eligible

16 Section 199A(d)(2)(A).

17 id. Section 1.199A-5(c)(1).

18 See id. Section 1.1502-13.

19 Sections 243(a)(3), (b)(1) and 246(c)(1)(A). The holding period is more than 45 days during the 91-day period beginning on the date 45 days before the applicable stock becomes ex-dividend. Corporations are also entitled to a 100 per cent deduction in respect of dividends from small business investment companies.

20 Sections 246 and 922 (prior to repeal by the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (P.L. 106519)).

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for a 100 per cent deduction, provided that the holding period is met.[21] The TCJA also included a one-time repatriation tax or 'toll charge' on the accumulated earnings and profits since 1986 of a controlled foreign corporation or a foreign corporation with one or more US corporations as shareholders, treating this income as taxable 'Subpart F income' (so named for the subpart of the Code imposing this tax) in the taxpayer's last taxable year beginning before 1 January 2018.[22]

Subpart F income is generally income from passive sources (dividends, interest, royalties, rents, insurance income and capital gains, etc.) and, together with investments in US property as defined in Section 956, it has long been taxable to US shareholders who own, directly or indirectly (but not constructively),[23] stock of controlled foreign corporations (CFCs). US shareholders are individual citizens or residents of the United States, as well as entities organised under the laws of the United States, any state or the District of Columbia, who own, directly, indirectly or constructively, 10 per cent of the vote or value of a foreign corporation. A CFC is a foreign corporation 50 per cent or more (by vote or value) of the stock of which is owned, directly, indirectly or constructively, by one or more US shareholders.

The TCJA modified corporate tax planning for Subpart F and Section 956 income by changing the definition of 'US shareholder' in two important ways. Prior to amendment, individuals or entities were US shareholders only if they owned 10 per cent of the vote of a foreign corporation; accordingly, shareholders willing to accept low-vote stock could, under certain circumstances, avoid being subject to Subpart F and Section 956.[24] More significantly, the TCJA greatly expanded the constructive ownership rules for purposes of determining whether a person is a US shareholder,[25] with the result that, in any worldwide group of corporations with a common foreign parent and a US subsidiary, virtually all foreign corporations that are direct or indirect subsidiaries of the common parent are likely to be CFCs, significantly expanding the base of Subpart F and Section 956 income. In addition, under customary terms of credit agreements, guarantees by and pledges of stock of a greater number of foreign corporations have been forbidden.[26] Tax planning for Subpart F and Section 956

21 The holding period applicable to dividends from foreign corporations is more than 365 days during the 731-day period beginning on the date 365 days before the applicable stock becomes ex-dividend. The Build Back Better Act proposed to limit the Section 245A deductions to dividends received from CFCs, but included an election to treat a foreign corporation as a CFC.

22 Section 965. To prevent taxpayers from entering into transactions to reduce the includible amount under Section 965, the relevant amount is the greater of the taxpayer's accumulated earnings and profits as of when the TCJA was introduced as a bill in the House of Representatives (2 November 2017) and when it became law (22 December 2017). Note that although the dividends received deduction has some of the effects of a participation exemption, the United States still taxes gain on the sale of stock of a subsidiary, whether domestic or foreign. In addition, under Sections 951 and 951A of the Code (discussed below), most income of controlled foreign subsidiaries will be subject to tax on a current basis (albeit at a reduced rate in the case of income other than Subpart F income).

23 'Indirect ownership' refers to ownership through an entity or chain of entities that owns stock in a CFC. 'Constructive ownership' refers to the complex rules of Section 318 (as modified by Section 958(b)) pursuant to which stock owned by other individuals or entities may be imputed to a related party.

24 See Section 951(b) (prior to amendment by the TCJA).

25 To be precise, under pre-TCJA law, Section 958(b) prevented 'downward attribution' under Section 318(a)(3) from applying so that stock of a subsidiary owned by a parent would not be attributed to other subsidiaries.

26 Under Section 956(d) and the regulations thereunder, a CFC guarantor of a US person's debt or a CFC two-thirds of the voting stock of which is pledged under such debt is considered the holder of the debt.

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must shift its focus to avoiding having US shareholders with a direct or indirect stake in a CFC rather than avoiding the creation of CFCs. The Build Back Better Act would further modify the application of constructive ownership rules for purposes of the identification of CFCs by generally reinstating prior law and creating a new category of CFCs, the income of which can be included by direct or indirect 'foreign-controlled US shareholders'. For US shareholders other than foreign-controlled US shareholders, this revision would make some pre-TCJA tax structures available to mitigate Subpart F and Section 956 income inclusions (and global intangible low-taxed income (GILTI) inclusions as well, discussed below).

International intercompany transactions

Perhaps the most significant challenge in designing incentives to generate and maintain earnings in the United States is the reality that the nation's economy increasingly depends on the exploitation of intangible assets, which are highly portable as a matter of legal form, and the Code tends to respect the legal form taxpayers choose. The TCJA purports to target the problem of taxing intangible income with a complex two-pronged approach: the 'carrot' of a deduction for foreign-derived intangible income (FDII) and the 'stick' of a tax on GILTI. GILTI and FDII sweep more broadly than the word 'intangible' implies, and need to be considered by any US corporation that earns income abroad, directly or through subsidiaries.

GILTI

Under Section 951A of the Code, US shareholders (including individuals) who own, directly or indirectly, stock of a CFC must include GILTI in their income. GILTI is defined as the excess of a US shareholder's aggregate pro rata share of the net tested income of each CFC of which the shareholder is a US shareholder over 10 per cent of the CFC's qualified business asset investment (QBAI), reduced by the interest expense taken into account in calculating the US shareholder's tested income (to the extent corresponding interest income is not taken into account).[27] Tested income is the gross income of each CFC, reduced by US-source income effectively connected with the conduct of a trade or business in the United States, Subpart F income, dividends received from certain related persons and deductions properly allocable to such income, in addition to certain other targeted exclusions.[28] QBAI is the average of a CFC's aggregate adjusted basis of depreciable tangible property that gave rise to tested income. Although GILTI resists conceptual oversimplification, one way to

Debt of a US person is considered an investment in US property, which gives rise to an income inclusion under Section 951(a)(1)(B). To prevent this inclusion, credit agreements frequently carve out CFCs from the list of subsidiaries that may guarantee debt and limit the amount of stock of a CFC that may be pledged. While regulations published in May 2019 generally harmonise inclusions under Section 956 with the participation exemption under Section 245A and thus alleviate, to a certain extent, the adverse effects of guarantees of debt by or pledges of stock of CFCs, eligibility for the Section 245A deduction is conditioned on the nature of the earnings distributed and the holding period of the stock in respect of which such earnings are distributed. In addition, the Section 245A deduction is calculated based on a corporation's total 'undistributed earnings', not taking into account the 'nimble dividend' rule that distributions from current earnings are taxed as dividends even if there is an aggregate earnings and profits deficit, which applies to deemed dividends under Section 956. See Sections 245A(c), 316(a)(2) and 956(b)(1)(B). Accordingly, multinational enterprises continue to prefer not to pledge more than 65 per cent of the voting stock of CFCs or have them guarantee US debt.

27 Section 951A(b)(2).

28 Section 951A(c)(2)(A).

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understand the provision is that Congress subjected income from intangible assets held in CFCs to current taxation and decided to calculate intangible income by providing that all income other than a 10 per cent deemed return on a CFC's investment in tangible property is derived from intangibles.

The TCJA also introduced two new tax benefits relevant to US corporations calculating GILTI. First, Section 250 allows a deduction of 50 per cent of a corporation's GILTI (reduced to 37.5 per cent for taxable years beginning after 31 December 2025), meaning that GILTI is effectively taxed to corporations at a 10.5 per cent rate for taxable years beginning before 31 December 2025, after which it will be taxed to corporations at 13.125 per cent (assuming no changes to the headline corporate tax rate). Second, the TCJA amended Section 960 to provide to US corporations a credit for foreign taxes deemed paid in respect of GILTI.[29] The amount of the tax credit available in respect of GILTI is limited by Section 904; importantly, GILTI falls in a new foreign tax credit 'basket' and, unlike the credits in respect of foreign branch, passive category and general category income, no carry-backs or carry-forwards are allowable in respect of excess credits from tax paid in respect of GILTI.[30] When the foreign tax credit in respect of GILTI is taken into account, according to the conference report accompanying the TCJA, the result should be that GILTI is taxed at a minimum combined US and foreign rate that ranges from 10.5 per cent (if the foreign tax rate is zero) to 13.125 per cent if the foreign tax rate equals or exceeds that amount.[31] However, the result that the legislative history suggests was intended will not be obtained if there are any expenses properly allocable to the GILTI basket. Section 904 requires US corporations to limit their tax credits in each relevant basket for each taxable year by the product of their foreign-source taxable income in the applicable basket for the year and the effective US tax rate on their worldwide income for the year.[32] If an item of expense is allocable to the GILTI basket, it will reduce the amount of taxable income offset by the GILTI foreign tax credit, dollar for dollar.[33] For this reason, depending on the availability of foreign tax credits allocated to other baskets, a taxpayer might prefer Subpart F income to GILTI, even though Subpart F income is taxed at a higher headline rate.

Treasury regulations[34] provide an electable 'high-tax exclusion' that permits taxpayers to omit GILTI subject to non-US tax at a rate of at least 90 per cent of the top marginal US corporate rate. Whether the high tax exclusion will benefit a particular taxpayer in a particular year will depend on that taxpayer's own facts and circumstances. For example, excluding highly taxed income from GILTI could reduce QBAI, thereby increasing the tested income that is ultimately subject to tax. Assessing the value of the high tax exclusion will thus be an important component of US multinationals' corporate tax planning.

29 Section 960(d). The credit equals 80 per cent of the product of a US corporation's 'inclusion percentage' and the 'tested foreign income taxes' paid or accrued by the CFC of which the US corporation is a US shareholder. The inclusion percentage is the quotient of a domestic corporation's GILTI inclusion over the aggregate amount of its pro rata share of each CFC's tested income; tested foreign income taxes are the foreign income taxes paid or accrued by the relevant CFCs properly attributable to tested income.

30 Section 904(c) (final sentence).

31 H.R. Rep. No. 115-466, at 626–27 (2017) (Conf. Rep.).

32 Section 904(a); for an explanation of how the statutory text yields this formula, see N.Y. State Bar Ass'n Tax Section, Report on the GILTI Provisions of the Code, Rep. No. 1394, 13 n.33 (May 4, 2018).

33 id. at 14, 70.

34 See Treas. Reg. Section 1.951A-2(c).

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FDII

FDII is a counterpart to GILTI, and the two concepts operate similarly in certain respects. In addition to the 50 per cent deduction for GILTI, Section 250 now allows a 37.5 per cent deduction in respect of FDII (scheduled to drop to 21.875 per cent for taxable years beginning after 31 December 2025), with the result that tax is imposed in respect of FDII at a rate of 13.125 per cent (scheduled to increase to approximately 16.4 per cent after 31 December 2025, assuming no headline rate change). In the absence of the FDII deduction, it would be more advantageous for US corporations to earn income overseas through CFCs because of the 50 per cent GILTI deduction.[35]

A US corporation's FDII equals its deemed intangible income multiplied by the ratio of its foreign-derived deduction eligible income over its total deduction eligible income. Deemed intangible income is the excess of deduction eligible income over a deemed tangible income return equal to 10 per cent of the corporation's QBAI (calculated in the same manner as in the GILTI context). Deduction eligible income is the gross income of the corporation (excluding Subpart F and Section 956 income, GILTI, financial services income, dividends from CFCs, domestic oil and gas extraction income, and foreign branch income) less deductions, including taxes, properly allocable to such gross income.[36] Finally, foreign-derived deduction eligible income is deduction eligible income derived in connection with property sold by the taxpayer to a non-US person and that is established to the satisfaction of the Secretary of the Treasury Department for a foreign use or in connection with services provided to any person who, it is established to the satisfaction of the Secretary, is located outside the United States or in respect of property located outside the United States.

Notwithstanding the parallels between GILTI and FDII and the IRS's analysis that the Section 250 deduction 'helps neutralize the role that tax considerations play when a domestic corporation chooses the location of intangible income attributable to foreign-market activity',[37] the continued complex calculations of GILTI and FDII and the foreign tax credits available to offset GILTI mean that comprehensive modelling will be required to determine whether a multinational enterprise would prefer to earn intangible income from sources outside the United States directly or indirectly through CFCs. In at least one high-profile instance, a major US corporation (Qualcomm) has determined that the benefits of FDII are significant enough that it has decided to elect to treat many of its former CFCs as disregarded entities, notwithstanding the recognition of income by a domestic corporation upon the liquidation of a foreign corporate subsidiary.[38]

Proposed legislation

The Build Back Better Act would revise GILTI and FDII with the result that both forms of deemed intangible income would be subject to tax at approximately 15 to 16 per cent, consistent with the OECD's proposed Pillar Two global minimum tax rate.

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35 See Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income, 84 Fed. Reg. 8,188, 8,189 (Mar. 6, 2019) (preamble to proposed regulations).

36 Section 250(b)(3)(A).

37 84 Fed. Reg. at 8,189.

38 Treasury Regulations Section 1.367(b)-3(b)(3)(i); see Amanda Athanasiou, Semiconductor Giant Restructures to Avoid BEAT, GILTI, 93 *Tax Notes Int'l* 451, 579 (Feb. 4, 2019).

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iii Third-party transactions

The TCJA dramatically changed the considerations relevant to taxable sales of CFCs. In particular, the dividends received deduction under Section 245A and the GILTI regime result in three tax rates for income that may be realised upon the disposition of stock in a CFC: 21 per cent for Subpart F income, 10.5 per cent for GILTI (until 31 December 2025, when the rate is scheduled to increase to 13.125 per cent) subject to reduction from foreign tax credits, and zero per cent for dividends (including gain recharacterised as a dividend under Section 1248) that satisfy the holding period and other requirements of Section 245A.

One of the principal questions facing parties to a stock sale is whether the purchaser should make (or the seller should contractually forbid the purchaser from making) an election under Section 338(g) in respect of such a sale. Without such an election, the consequences of a sale of a CFC are that the US parent recognises gain to the extent that the price of the stock exceeds the parent's basis in it.[39] This gain is treated as a dividend under Section 1248 to the extent of the CFC's post-1962 accumulated earnings and profits (E&P). If a Section 338(g) election is made (and, absent a contractual agreement to the contrary, a purchaser may make such an election in its discretion), in addition to the stock sale that actually occurs, the transferred corporation (referred to as the 'old target') is deemed to sell its assets to a new corporation (referred to as the 'new target'). As a result, the transferred corporation realises asset-level gain and takes a stepped-up tax basis in its assets. Where the target is a US corporation, the deemed asset sale is treated as occurring after the stock sale, meaning that the acquirer would bear the burden of the asset-level tax;[40] however, in the case of a foreign target, the asset sale is treated as having occurred while the seller still owned the target stock,[41] resulting in potential GILTI and Subpart F inclusions to the seller in addition to any gain on the stock sale.

The complex interplay of new and old tax rules means that there is no rule of thumb that making or not making a Section 338(g) election will tend to be better for a seller or a buyer of a CFC. One factor to consider is that, if the US parent satisfies the Section 245A holding period, then to the extent of the CFC's foreign-source earnings and profits, the gain will be treated as a dividend and eligible for the 100 per cent dividends received deduction. Although a deemed asset sale would generate E&P, it would also most likely generate Subpart F income and GILTI. Both these kinds of income result in an upward adjustment in the seller's basis in the target, reducing the gain on the stock sale (and therefore the amount of gain treated as a dividend under Section 1248).[42] Accordingly, a US owner of a CFC with accumulated E&P might prefer that a buyer not make a Section 338(g) election; however, a US owner of a CFC without E&P might prefer a Section 338(g) election, particularly if the asset-level gain gives rise to GILTI, because, although GILTI is effectively taxed at a lower rate than dividends, capital gain and Subpart F, amounts realised in respect of GILTI give rise to a full upward basis adjustment in CFC stock.[43]

39 Section 1001(a).

40 Section 338(a)(2).

41 Treasury Regulations Section 1.338-9(b)(2).

42 Section 961(a).

43 For a more detailed examination of the computational issues relating to Section 338(g) elections in the international context, see Tijana J Dvornic, International Corporate Transactions and Restructurings in the New (Post TCJA) Environment, 9–17 (N.Y.U. Sch. Prof. Stud., 77th Inst. Fed. Tax'n 2018).

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III INTERNATIONAL DEVELOPMENTS AND LOCAL RESPONSES

i OECD-G20 BEPS initiative

The United States has taken limited steps in response to the Action Plan on Base Erosion and Profit Shifting (BEPS) published in 2013. In 2015, the IRS promulgated country-by-country reporting regulations, consistent with BEPS Action 13.[44] The rules require US-parented multinational groups to file an annual report containing information on a country-by-country basis relating to the group's income taxes and indicators of the locations of economic activity within the group. In addition, the US model income tax treaty contains a limitation on benefits provision similar to that of the OECD Model Tax Convention, which was revised in light of the US model.[45]

Despite the United States's lukewarm reception of the OECD's BEPS initiative, the nation's tax policy has focused on targeting some of the same goals, and certain elements of the TCJA influenced the OECD's latest round of proposals addressing remaining BEPS challenges, particularly Pillar Two. To combat base erosion, the TCJA included a new base erosion and anti-abuse tax (BEAT), which is, generally, 10 per cent of the excess of taxable income (without regard to (1) tax benefits from certain base erosion payments and (2) a portion of net operating losses calculated based on the amount of base erosion tax benefits relative to certain other tax benefits) over regular tax liability (less certain credits).[46] In 2025, the BEAT is scheduled to increase to 12.5 per cent, and the regular tax liability will be calculated net of all tax credits.[47] Base erosion payments are deductible payments, including interest, but subject to certain exclusions, including services eligible for the service cost method,[48] purchases of deductible or amortisable property, and certain reinsurance payments, in each case, by US persons to related non-US persons.[49] The BEAT applies to C corporations with gross receipts in excess of US$500 million for the three-year period ending with the preceding taxable year and a base erosion percentage of 3 per cent (2 per cent in the case of banks and securities dealers).[50] The base erosion percentage is the aggregate amount of deductions allowable in respect of base erosion payments (other than fixed, determinable, annual or period payments subject to withholding under Sections 871 and 881) (base erosion tax benefits) divided by the taxpayer's total allowable deductions (other than deductions in respect of net operating losses, Section 245A, FDII and GILTI).[51]

Regulations provide a number of clarifications, including coordination with Section 163(j) to prevent a disallowed interest deduction from constituting a current-year base erosion tax benefit[52] and an exception to the general definition of 'base erosion payments' for payments treated as income that is effectively connected with a US trade or business.[53]

44 Treasury Regulations Section 1.6038-4.

45 See 2017 Update to the OECD Model Tax Convention (21 November 2017), www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf.

46 Section 59A(b)(1).

47 Section 59A(b)(2).

48 See Treasury Regulations Section 1.482-9.

49 Section 59A(d).

50 Section 59A(e).

51 Section 59A(c)(4).

52 Treasury Regulations Section 1.59A-3(c)(4).

53 Treasury Regulations Section 1.59A-3(b)(3)(iii).

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Pillar Two of the programme of work for addressing the tax challenges of the digitalisation of the economy 'calls for the development of a co-ordinated set of rules to address ongoing risks from structures that allow [multinational enterprises] to shift profit to jurisdictions where they are subject to no or very low taxation'.[54] These rules impose a minimum level of tax on certain payments between related parties (the 'subject to tax' rule) in a manner that is not dissimilar to the BEAT, and the Global Anti-Base Erosion Proposal (GloBE) shares features with GILTI, generally intending to impose a minimum tax rate on global income.

In general, President Biden has expressed greater enthusiasm for international cooperation than his predecessor, and even the former administration's Secretary of the Treasury expressed support for the GloBE project. The Build Back Better Act contains a number of proposals that are integrated with Pillar Two. The legislation imposes a 15 per cent minimum tax on the book income of corporations with over US$1 billion of book profit, in line with the GloBE rate. In addition, the Act would exclude from BEAT certain payments to affiliates of non-US multinationals subject to the OECD Pillar Two income inclusion rule, meaning that if Pillar Two is widely adopted, the BEAT would generally apply to multinationals headquartered in jurisdictions that do not implement Pillar Two.

ii Tax treaties

The United States' income tax treaty network covers most of the world's major economies, including every member of the European Union other than Croatia, and every member of the G20 other than Argentina, Brazil and Saudi Arabia. There are few treaties with nations in Africa (Egypt, Morocco, South Africa and Tunisia) and South America (Trinidad and Tobago and Venezuela). Several agreements – replacing existing treaties (Hungary and Poland), entering into a tax treaty for the first time (Chile and Vietnam) or amending current treaties (Japan, Luxembourg, Spain and Switzerland) – have been signed but not ratified by the US Senate.

To take effect, treaties must be ratified by a two-thirds vote of the Senate (one house of the US legislature). Although historically tax treaties have not been controversial, none of the tax treaties or protocols amending tax treaties pending before the Senate since 2010 has been ratified. The immediate cause for the failure to ratify tax treaties has been a 'hold' placed on all tax treaties by one senator over purported objections that the information-sharing provisions of tax treaties violate the constitutional right to privacy.[55] The prospect for ratification of any new tax treaties with the United States is likely to remain dim for the foreseeable future.

Notwithstanding the calcified legislative process that prevents the United States from putting tax treaties into force, the model US tax treaty remains influential. In particular, the changes to the OECD model treaty published in connection with its 2015 final report on BEPS reserved the text of the limitation on benefits provision until such time as the United States model treaty had been completed.[56] Limitation on benefits provisions are designed to prevent treaty shopping, and they generally test whether a person claiming the benefits of a

54 Organisation for Economic Cooperation and Development, Public Consultation Document: Global Anti-Base Erosion Proposal (GloBE) – Pillar Two (2019).

55 See Letter of Rand Paul to Harry Reid, 7 May 2014, http://online.wsj.com/public/resources/documents/PaulLetter050714.pdf.

56 See 2017 Update to the OECD Model Tax Convention, www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf.

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particular treaty has a sufficient relationship to the state where it claims residency to justify a reduction in or elimination of tax by the state where income is derived.[57] The OECD and US models take similar approaches to this article, and until the US technical explanation of its 2016 model treaty is released, the OECD's commentary will be useful in understanding both models.

IV OUTLOOK AND CONCLUSIONS

For many years, fundamentally rethinking the US tax code has proved easier said than done. The TCJA made certain updates to reflect changes in the business world since 1986 but in a manner that furthered the political agenda of the Republican Party, which is currently out of power. And although no major tax legislation has passed since President Biden's election, which coincided with unified Democratic control over the legislature, the Build Back Better Act attracted significant support and is likely to provide the framework for the next iteration of tax reform, if any, during his administration. The proposed legislation would generally increase the tax cost of US-parented groups' foreign operations and advance the OECD's Pillar Two by creating a minimum tax and removing certain incentives to headquarter in low-tax jurisdictions. And, like the TCJA before it, any successor to the Build Back Better Act appears less likely to result in fundamental structural reform to the Code than to enlarge and complicate a body of law not celebrated for its concision or coherence, presenting new planning challenges and opportunities to the well-advised.

57 Levine and Miller, 936 T.M., U.S. Income Tax Treaties – The Limitation on Benefits Article.

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Appendix 1

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Jodi J Schwartz focuses on the tax aspects of corporate transactions, including mergers and acquisitions, joint ventures, spin-offs and financial instruments. Ms Schwartz has been the principal tax lawyer on numerous domestic and cross-border transactions in a wide range of industries. She was elected partner in 1990. Ms Schwartz is recognised as one of the world's leading lawyers in the field of taxation, including being selected by *Chambers Global Guide to the World's Leading Lawyers*, *Chambers USA Guide to America's Leading Lawyers for Business* and *Who's Who Legal: Business Lawyers* and as a tax expert by *Euromoney Institutional Investor Expert Guides*. In addition, she is a member of the executive committee and past chair of the tax section of the New York State Bar Association, and also is a member of the American College of Tax Counsel.

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