Baker McKenzie.

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Tax News and Developments
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In This Issue:

Waiting For CARES Act 2.0? It May Be A While

While businesses appreciated the tax provisions that Congress included in the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), which was enacted on March 27, 2020, the consensus among businesses, trade organizations, and other interested stakeholders that additional stimulus and legislation is necessary has only grown as the COVID-19 pandemic continues to impact Americans.

However, this consensus view is not necessarily shared by Congress and the White House, where several different options are being considered as next steps. The White House has asked Congress for a payroll tax holiday and is focusing on the administration of the various funding facilities provided for in the CARES Act. But there's no groundswell of support for a payroll tax holiday on either side of the aisle in Congress.

Senate Majority Leader Mitch McConnell (R-KY) has stated publicly that Senate Republicans will not agree to additional COVID-19-related stimulus unless Democrats agree to limit liability from suit for businesses that have reopened or are seeking to reopen. Democrats have loudly and repeatedly rejected this request.

On May 12, the House Democrats released a 1,815 page bill, the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, that included funding for state and local governments (which some, but not all, Republicans object to), additional stimulus payments for Americans, and additional health-care related provisions. The House passed the HEROES Act on May 15, along with temporary voting changes that permit House members to vote by proxy. Senate Republicans have indicated that the bill is dead on arrival in the Senate but seem to have shifted from taking a "wait and see" approach to determine the impact of already-enacted stimulus legislation to considering additional stimulus.

The lack of consensus and a constantly changing Congressional calendar make it difficult to predict when additional legislation will be enacted, but, barring any unforeseen developments, we do not expect legislation to be enacted before late May to mid-June.

One bright spot in this murky future is that there appears to be bipartisan interest in making refinements to some of the tax provisions included in the CARES Act. For example, the Employee Retention Credit was widely praised when it was enacted, and there have been numerous calls to expand upon that credit in future legislation. The HEROES Act incorporated bipartisan legislation that would increase the amount of the credit and expand the scope of taxpayers who may claim the credit. We believe that an expanded Employee Retention Credit has a good chance of being enacted into law this summer. Another provision that may be favorably revised in future legislation is the NOL provision. Many taxpayers, while grateful for the ability to carry back NOLs generated in 2018,

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Upcoming Tax Events

SALT Webinar Series

False Claims Act and SALT (registration link)

►June 3, 2020

Handling a State Tax Controversy (registration link)

►June 10, 2020

To review the complete Tax Events Calendar visit www.bakermckenzie.com/tax/event

2019, and 2020, have told their Congressional representatives that allowing taxpayers to "monetize" their 2020 NOLs *in 2020*, rather than waiting until 2020 tax returns are filed in 2021, would provide a much-needed boost of liquidity. Members seem willing to consider this and other proposals that would provide an immediate liquidity boost to companies. In addition, Senators Grassley (R-IA) and Wyden (D-OR) and Representative Neal (D-MA) have partnered to push back on Treasury when they believe that Treasury has issued guidance implementing the CARES Act that is inconsistent with Congressional intent and denies benefits that Congress intended to provide to taxpayers.

Taxpayers should continue engaging with their Congressional delegations on needed legislation and any concerns about Treasury and the IRS's implementation of the CARES Act.

By Christopher H. Hanna, Dallas, Alexandra Minkovich and Josh D. Odintz, Washington, DC

IRS's Increased Use of FAQs to Implement the CARES Act

Following the enactment of the Coronavirus Aid, Relief, and Economic Security ("CARES Act") in March 2020, the IRS has tremendously increased its use of FAQs to quickly put out needed guidance--both substantive and procedural--to implement many of the new provisions. While no one disagrees that these FAQs provide IRS guidance and significant financial relief to taxpayers in real time during this crisis, taxpayers should be mindful that, as a form of guidance, FAQs may have significant limitations. In deciding how to apply the FAQs, taxpayers should be aware of those limitations to avoid unexpected consequences.

Traditionally, the IRS uses FAQs to explain formal guidance to taxpayers in plain language or to issue non-binding guidance in an emergency. In some cases, Treasury and the IRS subsequently issue FAQs in more formal guidance (such as a notice, revenue ruling, or revenue procedure) that is binding on the IRS and that taxpayers can rely on. It is notable that regulations, revenue rulings, revenue procedures, notices, and announcements are all identified as types of "published guidance" in the Internal Revenue Manual ("IRM"), but the IRM is silent on whether FAQs are also published guidance and what the processes are for drafting and reviewing FAQs. This silence should serve as a red flag to taxpayers that FAQs are different from regulations, revenue rulings, and other forms of published guidance. Taxpayers should proceed with caution when an FAQ is the only item the IRS has published interpreting a statute.

At the time of writing, the IRS has posted on its website at least 10 sets of FAQs, covering a wide range of key tax relief provisions from the CARES Act. Topics include economic impact payments, deferral of employment tax deposits and payments, the employee retention credit, Paycheck Protection Program loans, the use of paid leave credits, and special filing and payment relief. Most of these FAQs provide procedural guidance, such as the FAQs announcing temporary procedures that allow taxpayers to fax quick refund claims relating to net operating loss deductions and alternative minimum tax credits of corporations. This is a traditional and appropriate use of FAQs. However, some of the FAQs address more substantive issues, such as the relaxation of tax residency requirements for nonresident aliens and foreign businesses impacted by COVID-19 emergency travel disruptions. As an interim step and in the interest of getting information to taxpayers on an expedited basis, this may be a reasonable use of the FAQ format.

But FAQs can be a trap for the unwary. Indeed, FAQs that are posted on IRS.gov, like those interpreting the provisions in the CARES Act, generally are not considered binding on the IRS and do not provide taxpayers with penalty protection if the taxpayer relies on the FAQs. (Occasionally, the IRS issues a notice that contains a list of FAQs; those FAQs should be treated differently because notices are binding on the IRS and taxpayers are permitted to rely on notices.) The IRS has, at times, been criticized for not explicitly stating whether taxpayers can rely on the FAQs posted on its website. *See* the Government Accountability Office Report, Virtual Currencies: Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance, February 2020, GAO-20-188, p. 21. At least one set of the CARES Act FAQs warns taxpayers not to rely on the FAQs, as the answers to the questions only provide responses to general inquiries and "are not citable as legal authority."

As noted above, the IRM is silent on the drafting and review process for FAQs posted to the IRS website. Taxpayers may not be aware that, unlike published guidance, FAQs are not always drafted by attorneys in the Office of Chief Counsel. In fact, procedural FAQs--such as what form to file or where to send a form--are often *not* drafted by attorneys and are instead drafted by non-legal staff who ultimately report to the IRS Commissioner, not the IRS Chief Counsel. Moreover, there is no consistent review process that applies to vet all FAQs before they are posted to the IRS's website. Occasionally, high-profile FAQs are reviewed by Treasury's Office of Tax Policy, and we understand that the FAQs regarding the Employee Retention Credit were reviewed by Treasury. In our experience, most FAQs typically are not reviewed by the Treasury Department and are not subject to as many levels of review at the IRS as published guidance.

Another risk to relying on FAQs that taxpayers should be aware of is that the IRS can and does change (or update) them periodically by simply replacing the FAQs or taking the old FAQs down when the IRS updates its website. An example of these frequent changes just occurred--on May 7, Secretary Mnuchin wrote a letter to Senators Grassley and Wyden and Congressman Neal, informing them that Treasury had reconsidered one of the FAQs relating to the Employee Retention Credit, due to correspondence they had sent to Treasury, and that the

FAQ would be revised. The revised FAQ was posted on the IRS website on May 8. As a result, unless a taxpayer regularly takes screenshots of the FAQs, there may not be any public record of old FAQ versions.

While this recent change benefits taxpayers, in a worst-case scenario, the IRS may change the answer to an FAQ unexpectedly to the detriment of taxpayers that have followed the original FAQ. One extreme example is the IRS's use of FAQs to provide information to taxpayers and their advisors on participating in the Offshore Voluntary Disclosure Program ("OVDP"). Readers may recall that the OVDP allowed taxpayers to declare previously-undisclosed offshore accounts in exchange for reduced penalties. As the Taxpayer Advocate Service detailed in its Fiscal Year 2017 Objectives Report to Congress, the OVDP FAQs were issued in such haste and so poorly drafted that the IRS had to clarify them repeatedly, leading the IRS to treat similarly situated taxpayers inconsistently. The IRS also changed the OVDP FAQs regularly without providing any formal record of what changed and when. The Taxpayer Advocate found that, in six months in 2011, the IRS made 12 changes to the 2011 OVDP FAQs, which were entirely removed from the IRS's website in 2016.

FAQs are traditionally intended to be a flexible method to communicate information to taxpayers and tax professionals quickly and in plain terms. As such, they are an important tool in the IRS's toolkit. However, taxpayers should be mindful that FAQs are materially different from the other items published by the IRS to avoid the risk of negative consequences. Given the emergency and magnitude of the COVID-19 crisis, the IRS apparently has determined that issuing FAQs is necessary to provide immediate taxpayer relief. In general, taxpayers and their advisors have appreciated the quick release of information from the IRS, and remain hopeful that Treasury and the IRS will subsequently formalize the FAQs in published guidance. But considering the wide-reaching effect of the CARES Act FAQs, taxpayers should also be mindful of the limitations of FAQs and act accordingly.

By Alexandra Minkovich and Winna Li, Washington, DC

The CARES Act and ASC 740

On March 27, 2020, President Donald Trump signed the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") into law. A Baker McKenzie Client Alert discussed the tax provisions contained in the Act. This article discusses some of the ASC 740 issues (accounting for income taxes) associated with several of the tax provisions.

Generally, ASC 740 requires that the tax effects of changes in tax laws or rates be recorded in the period of enactment. The enactment date is the date the President signs the bill into law. As a result, with President Trump signing the

CARES Act into law near the end of the first calendar quarter (March 27, 2020), the changes must be recorded in the first quarter of 2020 for calendar year corporations (and the relevant quarter for fiscal-year corporations).

Net Operating Losses

After the enactment of the Tax Cuts and Jobs Act ("TCJA") in 2017 and prior to the enactment of the CARES Act, corporations could carry a net operating loss ("NOL") only forward, not back. The carryforward period was indefinite (as compared to 20 years prior to the TCJA), and an NOL could only offset up to 80 percent of taxable income (a limitation that was introduced in the TCJA). The NOL carryforward created a deferred tax asset for a corporation equal to the amount of the NOL carryforward multiplied by the 21 percent US corporate income tax rate. A valuation allowance was recorded based on the portion of the deferred tax asset for which it is more likely than not that a tax benefit would not be realized by the corporation. In order to realize the tax benefit of an NOL carryforward, a corporation needed sufficient taxable income within the carryforward or carryback period under the tax laws.

The CARES Act provides corporations a five-year carryback for NOLs generated in taxable years beginning in 2018, 2019 and 2020. FASB has identified four sources of taxable income that may be available under the tax laws to realize a tax benefit for net operating losses. One source is taxable income in a prior carryback year if a carryback for an NOL is permitted under the tax laws. This source of income became irrelevant (for US purposes) for an NOL after enactment of the TCJA. With carrybacks now permitted for NOLs arising in 2018, 2019 and 2020, taxable income in a prior year is relevant in determining whether a valuation allowance is needed against a deferred tax asset established as a result of an NOL.

A corporation that has recorded a deferred tax asset for an NOL arising in 2018 or 2019 that will be carried back to a pre-2018 year pursuant to the CARES Act will record a tax benefit because the resulting carryback refund will be measured at the 35 percent rate versus the 21 percent rate at which the deferred tax asset had been measured before the CARES Act. An NOL created in 2020 that will be carried back to a pre-2018 year should be recorded at a 35 percent rate.

In taxable years before 2021, NOLs may be utilized in such years without regard to the 80 percent of taxable income limitation. This may affect the determination for the recording and amount of a valuation allowance.

There may be interactive effects between the NOL rules and the global intangible low-taxed income, foreign-derived intangible income and base erosion and anti-abuse tax provisions. Such effects would need to be considered in determining the ASC 740 implications.

Section 163(j) Business Interest Expense

After the enactment of the TCJA and prior to the enactment of the CARES Act, corporations (and partnerships) could only deduct business interest expense equal to the sum of business interest income, 30 percent of adjusted taxable income ("ATI") and floor plan financing interest. Any business interest expense disallowed as a deduction is carried forward to the next year. For purposes of ASC 740, any disallowed business interest expense that is carried forward results in the recording of a deferred tax asset (equal to the carryforward amount multiplied by 21 percent corporate tax rate). Some corporations have established a valuation allowance concluding that it is more likely than not that a tax benefit will not be realized by the corporation. See Emily L. Foster, Financials Reveal Hazards of Interest Limitation Deduction Rules, 166 Tax Notes 1799 (Mar. 16, 2020).

As part of the CARES Act, Congress temporarily increased the percentage limitation of deductible business interest expense from 30 percent to 50 percent of ATI. The increased percentage is only applicable for taxable years beginning in 2019 and 2020. A corporation may elect to use its 2019 ATI in lieu of its 2020 ATI in determining its deductible business interest expense for the year. The higher percentage may reduce the business interest expense carryforward and therefore the corresponding deferred tax asset. A corporation may also need to redetermine its valuation allowance (if any) that it has recorded. In addition, to the extent the additional business interest expense deduction results in an NOL for that tax year, it could result in a carryback (or larger carryback) of NOLs to a 35 percent tax year.

Qualified Improvement Property

As part of the TCJA, Congress eliminated the separate definitions of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, and provided a general definition of qualified improvement property ("QIP"). Congress intended QIP to be depreciable property with a recovery period of 15 years. By having an applicable recovery period of 20 years or less, QIP would be "qualified property" under Code Section 168(k) and thus taxpayers could immediately expense the cost of QIP through their 2022 taxable year.

In the TCJA, Congress defined qualified improvement property, but failed to include the 15-year recovery period for it. As a result, immediate expensing was not available.

As part of the CARES Act, Congress included a technical correction providing a 15-year recovery period for QIP with an effective date retroactive to the date of enactment of the TCJA. The technical correction may allow for recognition of a tax position taken in a prior period that did not previously meet the more-likely-than-not recognition threshold. To the extent the expensing of QIP results in an NOL for that tax year (2018, 2019 or 2020), it could result in a carryback (or larger carryback) of NOLs to a 35 percent tax year.

By Christopher Hanna, Dallas and Matt Nochowitz, Chicago

COVID-19 Practical and Timely Government Concessions: Guidance on Permanent Establishments and Corporate Residency

The COVID-19 crisis and follow-on travel restrictions caused practical tax law interpretation and application challenges for businesses and tax authorities alike. The rapidly implemented global lock-downs that resulted in many employees working from home left little room for businesses to weigh the potential tax consequences from such ad hoc arrangements. In particular, do employees working from home suddenly create a permanent establishment or other taxable presence for a business, when the employees are locked down in a country different from their regular place of business? Likewise, what happens to a company whose Board of Directors ("BoD") can no longer convene in-person meetings at the regular headquarters of the company? Will its place of effective management shift to a different country resulting in the company becoming subject to residence taxation in a country other than the country of incorporation? This alert provides updates on what the Organisation of Co-Operation and Economic Development ("OECD") and various countries are doing to address the many issues raised by remote workforces, as highlighted in Baker McKenzie's recent piece, "*INSIGHT: Transfer Pricing Considerations for Remote Workforces*," published by Bloomberg.

Impressively, the OECD and various jurisdictions around the world have jumped to provide timely guidance that such temporary arrangements should logically not lead to adverse tax consequences. The OECD published guidance through a "*Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis*" (the "OECD Guidance") of April 2, 2020 and so did several countries, such as Australia, the UK, and the United States to name a few. The OECD Guidance is a secretariat analysis and is not aligned with the OECD member countries. Australia's guidance is a particularly good example in this context. Australia was one of the first countries to issue guidance, however its guidance is not strictly aligned with the OECD Guidance on all issues. Because of possible differences between domestic laws in various jurisdictions, specific country guidance around the world is still welcomed.

Permanent Establishments ("PE")

OECD Position

The OECD generally states that it is unlikely that the COVID-19 situation will create any changes to a PE determination.

The OECD comes to the conclusion that a home office created only because of the COVID-19 crisis should not constitute a PE. For one, the home office was not created as a result of a business choice but through mandated governmental directives. The guidance provides that where a company is having an employee work from home as a result of mandatory governmental restrictions, such action cannot result in the home office becoming a fixed place of business. Further, except through that one employee, the business does not have access to or control over the home office, and therefore, the fixed place is also not at the disposal of the business. Lastly, the guidance provides that the home office is implemented for a certain limited period of time only, namely until the crisis is over, which supports the lack of the necessary degree of permanency (unless the arrangement will become permanent over time).

On dependent agent PEs the OECD Guidance employs the same line of argument. For a dependent individual present in a certain country to lead to a PE, the individual must habitually exercise the authority to conclude contracts in the name of or to be performed by the foreign company. The OECD Guidance concludes that having an agent in a country only for a temporary period of time and solely due to "force majeure" as a result of the COVID-19 crisis is unlikely to be considered as habitual and will in principle be merely transitory, thereby not meeting the permanency requirement under Article 5(5) of the OECD Model Tax Convention. This analysis equally applies to Article 5(5) of the pre-2017 OECD Model Tax Convention as well as to the revised 2017 version of Article 5(5).

The guidance regarding home offices and dependent agents is, of course, welcome news to businesses. However, it should be noted that the OECD analysis hinges in part on the temporary nature of this crisis and, therefore, on the temporary nature of the new business arrangements. Businesses should continue to monitor on an on-going basis the potential tax risks of their arrangements in the context of COVID-19 and possibly document the extraordinary and temporary nature of their arrangements.

Australia's Position

On March 17, 2020, prior to the OECD release, the Australian Taxation Office (the "ATO") had crafted guidance concerning PE risks in Australia associated with COVID-19. Unlike the OECD Guidance, Australia's guidance does not go into detail regarding dependent agent PEs. The ATO's high level guidance is in the form of informal guidance on its website and "Questions and Answers" applying to various scenarios.

A scenario considered by the ATO involves a foreign incorporated company that is not an Australian tax resident and that has an unplanned presence of employees in Australia. In response to this scenario, the ATO states that the effect of COVID-19 will not, in itself, result in the company having an Australian PE if it meets all the following elements:

- The foreign incorporated company did not have a PE in Australia before the effects of COVID-19;
- There are no other changes in the company's circumstances; and
- The unplanned presence of employees in Australia is the short-term result of them being temporarily relocated or restricted in their travel as a consequence of COVID-19.

The ATO notes that it will not apply compliance resources to determine whether the foreign company has a PE if the foreign incorporated company did not otherwise have a PE in Australia before the effects of COVID-19, and if employees are temporarily relocated or are restricted in their travel as a consequence of COVID-19.

It will be important to confirm that the nature of the employees' work has not changed while they are in Australia as the guidance may not apply in these circumstances, for example, if the employee begins to conduct sales or marketing activities with Australian customers.

US Guidance

On April 21, 2020, a bit later in the COVID-19 global crisis, the IRS issued a short "*Information for nonresident aliens and foreign businesses impacted by COVID-19 travel disruptions*" statement (the "FAQs"). The FAQs address via two questions and answers whether the business activities of individuals who are unable to leave the United States due to government-imposed travel restrictions or social distancing recommendations give rise to a taxable presence for their employer in the United States. The FAQs apply to both the "US trade or business" ("USTB") standard under domestic law and the general PE standard under US tax treaties.

The guidance allows foreign corporations to choose an uninterrupted period of up to 60 calendar days, beginning on a date on or after February 1, 2020, and on or before April 1, 2020, during which services or other activities conducted in the United States will not be taken into account for purposes of determining whether that foreign corporation is engaged in a USTB or has a PE. This relief only applies if the activities were performed by individuals temporarily present in the United States, and would not have been performed in the United States but for travel disruptions due to the COVID-19 emergency. Each individual in question must be either (1) a nonresident alien, or (2) a US citizen or green card holder who has a foreign tax home (taking into account the additional relief provided in Rev. Proc. 2020-20 dealing with US taxable residency for individuals). Foreign corporations availing themselves of this relief should retain contemporaneous documentation, particularly with respect to the 60-day period referenced above. The foreign corporation should also be able to establish that the activities would not have been performed in the United States but for the COVID-19 emergency.

On May 6, 2020, the IRS issued additional guidance on whether the activities of employees stranded abroad would create a foreign branch for US federal income tax purposes. Rev. Proc. 2020-30 applies the same 60-day exemption for activities of individuals temporarily present in a foreign country for purposes of (1) determining whether a domestic corporation has a "foreign branch separate unit" under the dual consolidated loss rules; and (2) whether a domestic corporation has the obligation to file a Form 8858, "Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)."

It is important to note that unlike the OECD Guidance, the IRS FAQs and Rev. Proc. 2020-30 clearly set a time limit by referring to the 60-day period. Given that the United States banned incoming travel from the Schengen area on March 13, 2020 and the EU banned incoming travel other than citizens from the EU or EEA and the UK on March 17, 2020, and taking into account that these bans are unlikely to be lifted any time soon, the 60-day period might not be long enough for the many ongoing remote businesses operations. The FAQs also do not address the situation where the individual in question is a US citizen or resident, but would have ordinarily travelled to the relevant country to carry out foreign work activities. This is a much more likely scenario than a foreign citizen being stranded in the United States, as even during the existing travel bans citizens were usually allowed to return back to their home countries.

Corporate Residency

OECD Position

The OECD Guidance also concludes that the temporary COVID-19 crisis and the temporary working from home activities of company executives abroad are unlikely to change the company's place of effective management and thereby its tax residency. A company has its place of effective management where the key commercial and management decisions are taken that are necessary for the conduct of the business as a whole. To analyze where the executives carry on their activities, all relevant facts and circumstances must be examined. This includes those activities pertaining to the business structure prior to and during the COVID-19 crisis. The "usual" and "ordinary" place of effective management must be determined by taking into consideration these factors over a longer period of time and not only during the crisis. This can result in a different determination than the place one would determine if one only looked to the situation during the crisis.

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Because the OECD Guidance again relies upon the temporary nature of the current situation, businesses should implement guidelines advising management to return to the ordinary course of business as soon as it is reasonably possible. Businesses also should monitor the feasibility of making changes to the temporary remote working structure and to do so if possible. The OECD reiterates that its conclusions are premised on the fact that the temporary working operations that businesses had to implement were not voluntary but required by "force majeure" and governmental directives. Therefore, as soon as businesses may freely operate again, adverse tax consequences might follow from their decisions not to revert back to regular business operations. Documentation on the extraordinary circumstances and the temporary nature of certain actions (e.g., documented in board minutes and alike) will be key to support the position that no PE was created and the effective place of management was not shifted, upon possible future inquiries by the tax authorities.

Australia's Position

One of the tests (among others) in Australia with respect to corporate residency is the central management and control test. The ATO has also released guidance (in the Question and Answer format) considering the fact pattern where a foreign incorporated company that is not an Australian tax resident has needed to make alternative arrangements for board meetings because of travel restrictions. The ATO has noted that if the only reason for holding board meetings in Australia or directors attending board meetings from Australia is because of the effects of COVID-19, then it will not apply compliance resources to determine if central management and control is in Australia. Specifically, the ATO recognizes that some boards of foreign-incorporated companies that are not Australian tax residents may temporarily suspend their normal pattern of board meetings because either:

- there are overseas travel bans or restrictions, or
- the board has made the decision to halt international travel because of the present uncertainties around international travel due to COVID-19.

The ATO notes that "[i]f these companies instead hold board meetings in Australia or directors attend board meetings from Australia, this will not by itself in the absence of other changes in the company's circumstances alter the company's residency status for Australian tax purposes."

Given that the guidance is relatively high level and not issued in a formal public binding ruling, companies should consider their own fact patterns closely in comparison to the examples provided by the ATO in order to form a view of whether they are likely to benefit from the ATO's concessionary approaches.

As the United States' corporate income taxation system is not based on the effective place of management rules but solely on the place of incorporation, the United States has not issued any such guidance.

Conclusion

The OECD and several jurisdictions have provided welcome practical and timely PE and corporate residence advice consistent with the unanticipated dynamics and extensive strain of the COVID-19 crisis on the ability of company workforces to work in their normal locations. Eliminating tax controversies relating to these obviously unintended events is smart for governments and taxpayers alike. However, as the crisis results in restrictions staying in place for a period longer than initially anticipated, businesses should monitor the issuance of revised guidance closely.

By Imke Gerdes, New York, Simone Bridges, Australia, Ivan Morales, Palo Alto and Katie Rimpfel, Washington, DC

CRA Provides Administrative Relief for International Tax Issues Arising from COVID-19 Travel Restrictions

As a result COVID-19, a number of international travel restrictions have been imposed by governments and businesses. Taxpayers have raised concerns that these travel restrictions could result in a number of potential Canadian tax issues. In response to the concerns raised by taxpayers, the Canada Revenue Agency ("CRA") has announced administrative relief relating to certain of these issues. The CRA has also undertaken to review additional issues on a case-by-case basis.

Given the uncertainty of the duration of the travel restrictions, the CRA has limited the relief to the period from March 16 to June 29, 2020. The CRA has indicated that the relief will then be extended if necessary, or rescinded if no longer required.

The relief applies to five impacted areas: (i) tax residency, (ii) carrying on business in Canada/permanent establishment determinations, (iii) cross-border employment income, (iv) certain waiver requests and (v) requests for compliance certificates in connection with dispositions of taxable Canadian property as follows:

Tax Residency

Individuals

- Where an individual has remained in Canada solely because of travel restrictions, that factor alone will not cause the CRA to consider the individual to be resident in Canada under the common law factual determination test. Canada also has a deeming rule pursuant to which an individual may be deemed to be resident in Canada if he or she is physically present in Canada for a period of 183 days or more in a tax year. Where an individual is unable to leave Canada solely due to travel restrictions, days spent in Canada will generally not count towards this limit, provided that the individual does return to his or her country of residence as soon as he or she is able to do so.

Corporations

- Generally, a corporation that is established under a foreign law will be resident in Canada if its "central management and control" is located in Canada. A key factor in this determination is the location of board of director meetings. For jurisdictions with which Canada has a tax treaty that, unlike the Canada-US tax treaty, contains a corporate residency tie-breaker rule that looks to the corporation's place of effective management, the CRA will, as an administrative matter, not consider a corporation to become resident in Canada solely because a director of a corporation must participate in a board meeting from Canada because of travel restrictions.

- Determinations of corporate residency involving potential dual residency with non-treaty jurisdictions will be determined on a case-by-case basis.

Carrying on Business in Canada / Permanent Establishment ("PE")

- A non-resident entity will not be considered to have a PE in Canada for tax treaty purposes solely because its employees perform their employment duties in Canada (including the 183-day presence test for the purposes a "services PE" under the Canada-US tax treaty) solely as a result of travel restrictions.

- A non-resident entity will not be considered to have an "agency" PE in Canada solely due to a dependent agent concluding contracts in Canada on behalf of the non-resident entity while the travel restrictions are in force, provided that such activities are limited to that period and would not have been performed in Canada but for the travel restrictions.

- Relief for residents of non-treaty countries who are carrying on business in Canada due to travel restrictions may be provided on a case by case basis.

- Regardless of whether relief is available, taxpayers carrying on business in Canada are required to file Canadian tax returns.

Cross-border Employment Income

- An individual that is a resident of the US may be taxable in Canada on remuneration derived in respect of employment services provided in Canada where the person is present in Canada for a period or periods exceeding 183 days in any twelve month period commencing or ending in the fiscal year concerned. Where non-resident individuals are exercising employment duties in Canada solely as a result of travel restrictions, the CRA will not count those days towards this 183 day test. A similar approach will be taken in applying the days of presence test in Canada's other tax treaties.

Waiver Requests

- Payments for services rendered in Canada by a non-resident employee or other service provider are typically subject to Canadian withholding and remittance requirements unless a waiver from the CRA is obtained. Where a waiver request has been submitted to the CRA, but the CRA has been unable to process the request within 30 days, the CRA will not assess a person who fails to withhold and remit the relevant amounts provided that the person took reasonable steps to ascertain that the non-resident payee was entitled to a reduction or elimination of tax by virtue of a tax treaty with Canada and the relevant amount was covered by the particular waiver request.

Taxable Canadian Property Compliance Certificates

- Where a request for a certificate of compliance in respect of a disposition of taxable Canadian property has not been processed by the CRA by the time that the purchaser's remittance is due (*i.e.*, within 30 days after the end of the month in which the property was acquired), the purchaser may request a "comfort letter" from the CRA. The comfort letter will advise the purchaser to retain the funds they have withheld (instead of remitting them to the CRA) until such time as the CRA is able to process the request and requests that the purchaser remit the required tax.

By Alex Pankratz and Andrew Morreale, Toronto

Treasury Issues Final Section 901(m) Regulations

On March 23, 2020, in the midst of the COVID-19 pandemic, Treasury and the IRS issued final regulations under Section 901(m) (the "Final Section 901(m) Regulations"). Section 901(m) limits the ability of a US taxpayer to claim foreign tax credits associated with certain enumerated transactions that are treated as asset acquisitions for US federal income tax purposes but are either treated as stock acquisitions or disregarded for foreign income tax purposes. The Final Section 901(m) Regulations remove temporary regulations and generally adopt the specific rules and complexities contained in the previously issued proposed regulations (the "Prior Regulations") with a handful of noteworthy changes.

Section 901(m) Refresher

Section 901(m) was added in 2010 as part of a broader crack-down on what Congress perceived as taxpayer abuse of the foreign tax credit provisions of the Code. Specifically, taxpayers had engaged in a number of different transactions to "hype" the rate of foreign tax paid. This planning relied on the fact that the amount of creditable tax paid to a foreign government is determined under foreign law, even though the "base" upon which those taxes are imposed (*i.e.*, earnings and profits or "E&P") is determined under US law. This disconnect allowed taxpayers to take advantage of the potentially higher tax asset basis and associated amortization to reduce earnings from a US tax perspective. In this scenario, the US tax base is burdened as compared to the potentially higher tax base under foreign law. As a result, the effective tax rate from a US perspective could be well above the statutory rate under foreign law. A typical example of this concept involves a transaction that is treated as an asset acquisition for US federal income tax purposes but is either treated as a stock acquisition (or disregarded) for foreign tax purposes, such as a stock purchase to which Section 338 applies.

Section 901(m) addresses this issue by limiting the foreign taxes that may be credited against a US taxpayer's income tax liability if the taxpayer enters into a transaction in which the assets acquired by the taxpayer have a higher US (but not foreign) tax basis after the transaction than the assets did prior to the transaction (*i.e.*, an "Aggregate Basis Difference"). Transactions that result in an Aggregate Basis Difference are collectively referred to as Covered Asset Acquisitions ("CAAs"). Once a taxpayer enters into a CAA, section 901(m) operates to convert a portion of the foreign target's creditable tax pool into a noncreditable expenditure. Section 901(m) refers to this noncreditable expenditure as the "Disqualified Portion" of otherwise creditable taxes paid by the foreign target, which is generally computed by dividing the US taxpayer's Aggregate Basis Difference with respect to its foreign assets by the foreign tax bases upon which the creditable tax is imposed.

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Although the foreign taxes attributable to a US taxpayer's Disqualified Portion are disqualified for foreign tax credit purposes, they can still be deducted. That is, the foreign tax credits are not made valueless, but section 901(m) reduces their value by an amount equal to one minus the US tax rate. For example, instead of claiming a credit of $100 for foreign income taxes of $100, thereby reducing US tax liability by $100, the taxpayer now deducts those $100 of taxes, which only provides a US tax reduction of $21 — a 79% reduction.

The Final Section 901(m) Regulations

The Final Section 901(m) Regulations retained the six types of CAAs set forth in the Prior Regulations. The first three CAAs are statutorily mandated. Treasury added the remaining three CAAs under the authority Congress granted to it in Section 901(m). The six types of CAAs are:

1. A qualified stock purchase to which section 338 applies;
2. Any transaction treated as an asset acquisition for US tax purposes and treated as a stock acquisition (or disregarded) for foreign tax purposes;
3. Any acquisition of a partnership with a section 754 election in effect;
4. Any transaction (or series of transactions under a plan) to the extent it is treated as an asset acquisition for US tax purposes and as the acquisition of an interest in a fiscally transparent entity for foreign tax purposes;
5. Any transaction (or series of transactions under a plan) to the extent treated as a partnership distribution of one or more assets the US basis of which is determined by section 732(b) or 732(d) or to the extent it causes the US basis of the partnership's remaining assets to be adjusted under section 734(b), provided the transaction results in an increase in the US basis of one or more of the distributed or retained assets without a corresponding increase in the foreign basis of such assets; and
6. Any transaction (or series of transactions under a plan) to the extent it is treated as an asset acquisition for purposes of both US income tax and a foreign income tax, provided the transaction results in an increase in the US basis without a corresponding increase in the foreign basis of one or more assets.

Notably, Treasury and the IRS declined to narrow the sixth CAA, despite receiving numerous comments from practitioners and companies arguing that section 901(m) should only apply to specifically defined transactions that are likely to "hype" foreign tax credits involving significant US tax planning. Commenters argued that the broad reach of the sixth CAA was inconsistent with the spirit of the CAAs identified in the statute. Commenters were also concerned that the sixth category, when combined with other aspects of the section 901(m) regime, raised considerable fairness concerns, including increased administrative costs for taxpayers executing non-abusive transactions. Despite these concerns, the preamble to the Final Section 901(m) Regulations states that Treasury and the IRS view section 901(m) as a mechanical rule that is not based on taxpayer intent, and, thus, its provisions should generally apply to *any* transaction that results in an Aggregate Basis Difference for US federal income tax purposes.

Despite the fact that Final Section 901(m) Regulations largely adopt the provisions set forth in the Prior Regulations, the following changes are worth noting. The definition of an Aggregate Basis Difference was modified to effectively provide an exemption for CAAs to the extent gain or loss is recognized by the US taxpayer eligible to claim the foreign tax credits. A new *de minimis* rule was added that disregards an Aggregate Basis Difference for an individual foreign asset that is less than $20,000. In addition, to reflect the statutory changes implemented by the Tax Cuts and Jobs Act ("TCJA"), the provisions contained in the Prior Regulations have been updated. For example, references to section 902 corporations are replaced with references to "applicable foreign corporations" and a definition of "separate category" is added and utilized to address the income groupings required under section 960, among other changes.

In a nod to taxpayers, the favorable "foreign basis election" for determining an Aggregate Basis Difference was retained. Under section 901(m), an Aggregate Basis Difference (as defined above) is equal to the difference between the US tax basis in the relevant asset before the CAA and the US tax basis of such asset after the CAA. The foreign basis election allows a US taxpayer to compare the US tax basis after the CAA with the foreign tax basis after the CAA to determine whether an Aggregate Basis Difference has occurred instead of using the US tax basis of the asset before the CAA for comparison purposes.

Finally, in instances in which section 901(m) and section 909 overlap, the Final Section 901(m) Regulations clarify that section 901(m) applies first to disqualify foreign taxes from being credited, after which the deduction with respect to such disqualified taxes may then be subject to deferral under section 909.

The rules contained in the Final Section 901(m) Regulations are applicable to taxpayers that enter into CAAs occurring on or after March 23, 2020.

The TCJA Impact

In an attempted shift to a territorial tax regime, the TCJA made a number of changes to how the United States taxes earnings a US corporation receives from its foreign subsidiary. Prior to the TCJA, US corporate taxpayers could claim a tax credit for foreign taxes paid on earnings of a controlled foreign corporation that were distributed or deemed distributed to a US shareholder. As part of the TCJA, Congress enacted section 245A, which permits a 100-percent deduction for the foreign-source portion of dividends received from a foreign subsidiary, provided certain requirements are met. Since section 245A generally alleviates double taxation concerns when a US taxpayer receives a foreign-source dividend, the TCJA disallowed foreign tax credits under Section 901 for taxes paid or accrued on dividends from foreign corporations. Consequently, while still important for cross-border mergers & acquisitions, the TCJA has limited the instances in which section 901(m) has a significant impact.

By Stewart Lipeles, Palo Alto and Jordan Hughes, Chicago

Putting a Spin on Section 355's Active Trade or Business Requirement

In PLR 202009002, the IRS determined that the absence of income collection during the five-year period preceding a spin-off did not prevent a research and development intensive business from satisfying the active trade or business requirement under section 355(b).

Section 355 allows a corporation ("Distributing") to distribute the stock of a controlled subsidiary ("Controlled") tax-free to its shareholders when certain requirements are satisfied. One such requirement is that Distributing and Controlled must each be engaged in the active conduct of a trade or business immediately after the spin-off (the "Active Trade or Business Requirement"). Specifically, (i) both Distributing and Controlled must be engaged in an active trade or business immediately after the distribution, (ii) each such post-distribution business must have been actively conducted throughout the five-year period ending on the date of the distribution, and (iii) each post-distribution business must not have been acquired by purchase or in another transaction in which gain or loss was recognized during such five-year period.

In order to be engaged in the conduct of a trade or business, each corporation must engage in a specific group of activities for the purpose of earning income or profit and the activities included in such group must include every operation that forms a part of, or a step in, the process of earning income or profit. According to the regulations, "[s]uch group of activities ordinarily must include the collection of income and the payment of expenses." Treas. Reg. § 1.355-3(b)(2)(ii). Thus, historically, Treasury and the IRS have generally required Distributing and Controlled to collect income throughout the five-year period preceding the spin-off.

On September 25, 2018, the IRS released a statement (the “September Statement”) announcing a study of the Active Trade or Business Requirement and, specifically, the requirement that a trade or business must ordinarily entail the collection of income. In discussing the reasoning for the issuance of the statement, the IRS noted that there has been a significant increase in entrepreneurial ventures whose activities consist of lengthy research and development phases during which the ventures often collect no or negligible income but nevertheless incur significant expenditures and engage in activities that have historically evidenced an active business, such as the performance of day-to-day operational and managerial functions. The IRS also noted that the venture may forego current income opportunities in favor of the prospect of increased future income through the development of its own products, and various research phases often require lengthy, complex, and expensive review processes. Until completion of the study, the IRS stated that it would entertain private letter ruling requests regarding the satisfaction of the Active Trade or Business requirement where an enterprise does not yet generate income.

PLR 202009002, released on February 28, 2020, was the first ruling that concluded that the absence of income collection in the five-year period preceding the spin-off did not prevent a business from satisfying the Active Trade or Business Requirement. There, Distributing conducted research and development activities to identify and create new products. In order to commercialize products in the particular industry at hand, a four-step process was generally required. Distributing’s Business 1 was defined as the activities involved in Steps 1 through 2C1 of the process, and Distributing had been engaged in such business for over five years. Over the course of such period, Business 1 generated income through research-oriented contracts (such as collaboration agreements) and licensing.

For over five years, Distributing was also engaged in Business 2, which was defined as Steps 2C2 through 3 of the above-discussed process. Throughout such period, Distributing allocated managerial and operational employee time to support Business 2 and thus incurred significant salary and wage expense. Business 2 had not yet generated income, but Distributing noted that Business 2 had the ability to generate income through research-oriented contracts and licensing throughout the last five years and offered evidence of deals between unrelated parties where upfront cash payments were made to the licensor in Step 2C of the process. Distributing further noted that it had decided to forego current income collection from Business 2 in favor of the prospect of generating significantly greater income after the completion of Step 3 but before commercialization.

Distributing proposed to separate Business 1 from Business 2 by forming Controlled, contributing Business 2 to Controlled in exchange for Controlled stock, and distributing Controlled to Distributing’s shareholders. Following the separation, Distributing will continue to conduct Business 1 and Controlled will conduct Business 2. In determining whether the Active Trade or Business Requirement was satisfied with respect to Business 2, the IRS determined that the absence of income collection does not prevent Business 2 from constituting a "trade or business" within the meaning of Treas. Reg. § 1.355-3(b)(2)(ii).

Unfortunately, PLR 202009002 does not discuss the weight given to each factor noted within the ruling. However, because (i) the ruling was issued in response to a February 1, 2018 submission, (ii) such submission predates the issuance of the September Statement, and (iii) the facts disclosed in the ruling align with those identified in the September Statement, it can be argued that the factors noted in the September Statement are amongst those that the Service will consider. Thus, in determining whether a business will satisfy the Active Trade or Business Requirement without the current collection of income, the following factors will likely be considered: whether the business was capable of collecting income in the five-year period preceding the spin-off; the nature and duration of the research phases in the applicable industry; whether significant financial expenditures were incurred; and whether the business performs day-to-day operational and managerial functions that historically have evidenced an active business.

It remains unclear whether all such factors must be present, the weight to be given to each factor, and whether a facts and circumstances determination will generally be used. In particular, it is unclear how much weight was given to the taxpayer's ability to demonstrate that its venture could have generated income during the five-year period preceding the distribution and whether the IRS would require a similar representation for other taxpayers. In any event, PLR 202009002 continues to provide helpful guidance for businesses with a significant focus on research and development activities and indicates that the IRS is willing to allow, at least under certain circumstances, the Active Trade or Business Requirement to be satisfied despite the lack of current collection of income. Further, given the IRS's willingness to entertain rulings on the satisfaction of the Active Trade or Business Requirement where there is no current income collection, it is worthwhile to consider the applicability of section 355 even if a taxpayer's particular situation does not fall squarely within the facts of PLR 202009002.

By Tatyana Johnson and Ashleigh Browne, New York

Changing the Past: CARES Act Depreciation Method and Interest Deduction Opportunities

On March 27, 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") to grant retroactive tax benefits to businesses by modifying certain provisions of the Tax Cuts and Jobs Act of 2017 ("TCJA"). To enable businesses, particularly partnerships, to benefit from these changes, the IRS has issued the following three revenue procedures:

- Depreciation Deductions under Rev. Proc. 2020-25: On April 17, 2020, the IRS issued Rev. Proc. 2020-25 to allow a taxpayer to change its method of accounting automatically to take into account the new 15-year tax life, or deduct 100% depreciation (bonus depreciation) in the first year, with respect to a qualified improvement property ("QIP") placed in service in tax year 2018, 2019, or 2020. This new change may avoid the need for a cumbersome amended return process.

  Generally, QIP is an improvement made to the interior portion of a nonresidential building that is not attributable to the enlargement of a building, any elevator or escalator, and the internal structural framework of the building. The TCJA simplified the definition of QIP, but failed to designate a 15-year recovery period for QIP, thus unintentionally disqualifying it from being property eligible for bonus depreciation. The CARES Act included a retroactive technical correction to address this error, and Rev. Proc. 2020-25 provides the various options for taxpayers to depreciate QIP over a 15-year period or to take QIP as bonus depreciation within the first year in which the QIP is placed in service in tax year 2018, 2019, or 2020.

  Additionally, the Revenue Procedure allows taxpayers to revoke or withdraw, or file late, certain other depreciation elections. Taxpayers should reconsider their recent depreciation elections, especially if they have placed any QIP in service in the past few years, to see which option now available is most beneficial in light of their particular circumstances.

- Interest Deductions under Rev. Proc. 2020-22: On April 10, 2020, the IRS issued Rev. Proc. 2020-22 setting forth the procedures for a real property trade or business to withdraw a previous section 163(j)(7) election out of the interest deduction limitation regime. Taxpayers may wish to reconsider their election out given that the election prevents them from electing newly eligible bonus depreciation for QIP, and especially given the temporarily higher 50% limitations for section 163(j) enacted as part of the CARES Act for tax years 2019 and 2020.

- Amending BBA Partnership Returns Under Rev. Proc. 2020-23: On April 8, 2020, the IRS issued Rev. Proc. 2020-23 to permit a partnership ("BBA partnership") subject to the unified partnership audit rules in the Bipartisan Budget Act of 2015 ("BBA") to amend its partnership return for tax year 2018 or 2019 in lieu of filing an administrative adjustment request ("AAR"). This is important because not only are the procedures under the BBA rules more cumbersome but they also do not otherwise provide a mechanism for refunds.

Changes to Depreciation Deductions and QIP

To take into account the new 15-year recovery period for a QIP or to claim the recently permitted bonus depreciation with respect to a QIP constitutes a change in accounting method, which would normally require consent from the IRS Commissioner. The late elections available under Rev. Proc. 2020-25 are also considered changes in method of accounting. However, if certain requirements are satisfied, Rev. Proc. 2020-25 provides automatic consent to make these changes.

Procedure to Make Retroactive Changes with Respect to QIP

Under Rev. Proc. 2020-25, a taxpayer can in certain circumstances make a retroactive change to account for the new 15-year recovery period, or take the bonus depreciation deduction, with respect to a QIP that has been placed in service by a taxpayer after December 31, 2017 for tax year 2018, 2019, or 2020. To make these changes a taxpayer can either (1) file an amended federal income tax return for the year when the QIP was placed in service or (2) file a Form 3115, *Application for Change in Accounting Method,* with the taxpayer's timely filed federal income tax return.

If a taxpayer decides to amend the federal income tax return in order to make the change, the filing of the amended return must be done on or before October 15, 2021 but in no event later than the applicable statute of limitations. A BBA partnership must instead follow the time frame to file its amended Form 1065 as set forth in Rev. Proc. 2020-23, and may also file an AAR in certain circumstances.

Alternatively, under Rev. Proc. 2020-25, a taxpayer generally can file a Form 3115 for a property that was placed in service after December 31, 2017, if the taxpayer adopted the method of accounting for two consecutive tax years preceding the change, and the taxpayer owned the QIP at the beginning of the year of change (the two year rule). However, Rev. Proc. 2020-25 provides an exception to allow a taxpayer who only applied such an impermissible method in the prior year (e.g., 2018) to change the method of accounting via Form 3115 in an immediately subsequent year (e.g., in 2019) (1-year QIP rule). Regardless of which rule applies, because the IRS considers this a change from an impermissible method to a permissible method, the additional depreciation is computed as a section 481(a) "catch-up adjustment" that is included in the return as a reduction to taxable income for the year of change.

Late ADS, No-Bonus-Depreciation, or 50% Deduction Election

Rev. Proc. 2020-25 provides the procedures to file late an election to depreciate a property under the alternative depreciation system (the ADS election), to take no bonus depreciation deduction or to take a 50%, instead of 100%, additional first year depreciation for certain qualified property in certain circumstances. In particular, certain late elections require that a taxpayer must have, on or before April 17, 2020, timely filed its federal income tax return or Form 1065 for the year in which such depreciable property was placed in service.

There are two options for making these late elections: either on an amended prior year return or on a Form 3115 reporting a change in accounting method in the current tax year. The amended federal income tax return for the year in which the property was placed in service must be filed on or before October 15, 2021 but in no event later than the applicable statute of limitations. Rev. Proc. 2020-23 separately determines the time frame to file amended returns for BBA partnerships, which may also file an AAR.

With respect to the Form 3115 option, one single form should be filed for all elections and can be submitted with a taxpayer's original federal income tax return filed either (1) in a taxpayer's first or second tax year succeeding the tax year in which the taxpayer placed the property in service; or (2) on or after April 17, 2020, but on or before October 15, 2021. Additionally, a section 481(a) adjustment must be made within this time frame, and the Form 3115 must provide a single net section 481(a) adjustment for all such changes.

Rev. Proc. 2020-25 also provides the option for eligible taxpayers to revoke or withdraw these elections with respect to qualified property. The procedures are generally conducted in the same manner and within the same time frames as provided with respect to filing late elections. However, the revocation of an ADS election can only be made via an amended return or AAR, as applicable.

Relaxation of the Interest Deduction Limitation

The TCJA included a new regime generally limiting a taxpayer's business interest deduction to the sum of business interest income and 30% of the taxpayer's adjusted taxable income ("ATI"). Real property trades or businesses are allowed to elect out of this limitation under section 163(j)(7) but at the cost of foregoing bonus depreciation and using the longer ADS tax depreciation lives. The CARES Act increased the interest limitation from 30% to 50% with respect to ATI for tax years 2019 and 2020, and provides an optional election to use a potentially higher 2019 ATI in determining the applicable limitation for 2020.

Withdrawal of an Electing Real Property Trade or Business Election

Rev. Proc. 2020-22 allows a real estate business to withdraw its election to be excluded from the section 163(j) interest limitation rules. To make such withdrawal, a taxpayer can timely file an amended federal income tax return or an AAR, as applicable, for the tax year in which the election was made along with a properly completed withdrawal statement.

The amended return must be filed on or before October 15, 2021, but in no event later than the applicable statute of limitations on assessment. A BBA partnership must file its amended return within the time frame provided in Rev. Proc. 2020-23, or may withdraw this election by filing a timely AAR. Whichever method is used, the taxpayer must include the adjustment to taxable income and tax liability in the amended return or AAR. The same procedure must also be followed for any affected succeeding tax years.

In deciding whether to withdraw this election in light of the higher interest limitations, real estate businesses should also consider the benefits of shorter depreciation lives and potential bonus depreciation available absent the section 163(j)(7) election. This tax benefit may be enhanced further with respect to a taxpayer's particular circumstances by the temporary repeal of the section 461(l) limitation on excess business losses and the temporary allowance of carryback and the carryforward of net operating losses. The potential benefits for past, present, and future tax years should be carefully modeled.

Special Rules for Partnerships

The CARES Act provides special interest limitation rules for partnerships and their partners. *See* Prior Alert, *"CARES Act Tax Provisions Impacting the Real Estate Industry*". Rev. Proc. 2020-22 also sets forth the time and manner for a partner to make or revoke an election with respect to excess business interest expense. Partnerships and partners should carefully consider the implications of the different options taking into account the special rules applicable to partnerships.

Filing Amended Partnership Returns

The IRS issued Rev. Proc. 2020-23 to allow a partnership to amend its federal income tax return, thus affording its partners the possibility of receiving tax refunds, which otherwise does not exist under the BBA rules. The relief is limited to BBA partnerships that filed a Form 1065 and furnished schedules to their partners for the 2018 or 2019 tax year prior to the issuance of this revenue procedure. An eligible BBA partnership can amend its 2018 or 2019 tax return by filing electronically or by mailing an amended partnership return as follows: (1) the amended return box is checked on the Form 1065; (2) "FILED

PURSUANT TO REV. PROC. 2020-23" is written on top of that form; and (3) corresponding amended Schedule K-1s are furnished to partners.

How to Move Forward

These revenue procedures should be assessed and analyzed together based on a taxpayer's particular circumstances. For example, taxpayers with significant QIP are more likely to benefit from revoking a section 163(j)(7) election. Additionally, taxpayers should consider the impact of the different options available to change past elections as provided in the various IRS guidance, along with the timelines and manner set forth by the IRS for taking advantage of these changes. These decisions affect several tax years--past, present, and future.

By Steve Schneider and Dinh Tran, Washington, DC and Sam Grilli, Chicago

Benefits of Selling Foreign IP to a Related or Unrelated Foreign Party Under the FDII Tax Regime

The foreign-derived intangible income ("FDII") rules have created opportunities for foreign corporations to cause their US subsidiaries to sell their foreign intellectual property in a cost effective manner.

Brief Overview

A sale of intangible property ("IP"), whether to a related or unrelated party, qualifies as a foreign-derived deduction eligible income ("FDDEI") sale for FDII purposes, to the extent that the intangible property generates revenue from exploitation outside the United States. This should include the sale of IP from a US corporate subsidiary ("US Sub") to its foreign parent, whether the parent is a corporation or partnership ("Foreign Parent"). As such, this should entitle US Sub to a 13.125% tax rate [*21% corporate rate – (37.5% FDII deduction x 21% corporate rate)*] on the gain from an IP sale to a Foreign Parent.

Law and Analysis

For purposes of determining the section 250 deduction for FDII, the FDII of a domestic corporation for a tax year is the corporation's deemed intangible income ("DII") for the year multiplied by the ratio of the corporation's FDDEI for the year to the corporation's deduction eligible income ("DEI") for the year.

FDDEI includes, with respect to any domestic corporate taxpayer for any tax year, any DEI of the taxpayer that is derived in connection with property that is sold by the taxpayer to any person who is not a US person, and which the taxpayer establishes to the IRS's satisfaction is for a foreign use. Foreign use means any use, consumption, or disposition which is not within the United States.

Sales of property, and services provided, to foreign persons related to the taxpayer may give rise to FDDEI. In the phraseology of the proposed regulations, these related party transactions *may* be FDDEI transactions, but the Code and proposed regulations impose limits on the eligibility of certain transactions with a "related party." In this context, a "related party" means any member of the domestic corporation's "affiliated group" with the definition of that term expanded from its root definition in section 1504(a). The at least 80 percent stock ownership test is watered down to more than 50 percent, and foreign corporations and insurance companies are included. Moreover, a person other than a corporation is included in the group if the person controls any member of the group or is controlled by group members. "Control" for this purpose is defined by section 954(d)(3), which essentially uses a more-than-50-percent ownership test.

The proposed regulations provide details for determining whether a sale of *general property* that would otherwise be a FDDEI sale (which the proposed regulations call a "related party sale") is disqualified because the transaction is with a related party. However, the proposed regulations on related party sales apply only to sales of general property, and specifically state that neither they nor the statutory rules on related party sales apply to sales of IP. More specifically, the preamble to the proposed regulations states "[s]ales of intangible property, whether to a related or an unrelated party, are for a foreign use only to the extent that the intangible property generated revenue from exploitation outside the United States. Thus, additional rules with respect to related party sales of IP are unnecessary to ensure that such sales are ultimately for a foreign use." The allowance for related party sales of IP is illustrated in an outbound section 351 and 367(d) deemed sale context under Prop. Treas. Reg. § 1.250(b)-4(e)(4)(ii)(F), Example 6.

The proposed regulations apply a separate test to determine whether IP (as defined under section 367(d)(4)) is sold for foreign use. Under Prop. Treas. Reg. § 1.250(b)-4(e)(1), a sale of IP is for a foreign use only to the extent the seller establishes that the sale is for a foreign use within the meaning of Prop. Treas. Reg. § 1.250(b)-4(e)(2) of this section by obtaining documentation described in Prop. Treas. Reg. § 1.250(b)-4(e)(3) (which meets the reliability requirements described in Prop. Treas. Reg. § 1.250(b)-3(d)) and, as of the FDII filing date, the seller does not know or have reason to know that the portion of the sale of the IP for which the seller establishes foreign use is not for a foreign use within the meaning of Prop. Treas. Reg. § 1.250(b)-4(e)(2).

Under Prop. Treas. Reg. § 1.250(b)-4(e)(2)(i), a sale of IP is for a foreign use only to the extent that the IP generates revenue from exploitation outside the United States. A sale of IP rights providing for exploitation both within the United

States and outside the United States is for a foreign use in proportion to the revenue generated from exploitation of the IP outside the United States over the total revenue generated from the exploitation of the IP. For intangible property used in the development, manufacture, sale, or distribution of a product, the IP is treated as exploited at the location of the end user when the product is sold to the end user.

Under Prop. Treas. Reg. § 1.250(b)-4(e)(2)(ii), in the case of a sale of IP to a foreign person in exchange for periodic payments, the extent to which the sale is for a foreign use is determined on an annual basis based on the actual revenue earned by the recipient for the taxable year in which a periodic payment is received. However, in the case of a sale of IP to a foreign person for a lump sum, the extent to which the sale is for a foreign use is determined based on the ratio of the total net present value of revenue the seller would have reasonably expected to earn from the exploitation of the IP outside the United States to the total net present value of revenue the seller would have reasonably expected to earn from the exploitation of the IP.

Prop. Treas. Reg. § 1.250(b)-3(g) states that, for purposes of determining whether a sale of property to a partnership is a FDDEI transaction, a partnership is treated as a person (i.e., the entity approach). As such, the sale of IP by a US corporate subsidiary to a foreign parent partnership should be treated as a sale to the foreign parent partnership (not its partners). Provided that a US corporate subsidiary can properly document the foreign use of the IP being sold, a sale should qualify as a FDDEI sale for purposes of the FDII rules.

Conclusion

The FDII tax regime provides an excellent opportunity to sell foreign IP from a US corporation to its foreign parent or another foreign party, whether related or unrelated, provided that the IP is used outside the United States. The US tax rate on the gain generally should be taxed at the favorable 13.125% rate.

By James Barrett, Abrahm Smith, Daniel Hudson, Miami

Should Faxing Be This Taxing?

On April 30, 2020, the IRS updated the Temporary procedures to fax certain Forms 1139 and 1045 due to COVID-19, to provide additional guidance to taxpayers seeking tentative refunds for net operating losses ("NOLs") and alternative minimum tax ("AMT") credits provided under the Coronavirus Aid, Relief and Economic Security ("CARES Act"). The FAQs provide a short-term faxing option to assist taxpayers due such refunds. Generally these forms must be filed as hard copies delivered through the mail or a private delivery service. The updated FAQs clarify that only Form 1139, *Corporation Application for Tentative Refund*, and Form 1045, *Application for Tentative Refund*, may be faxed to the number provided under the temporary relief procedures. Sounds

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pretty simple so far. It is not so simple if the taxpayer must file an amended return for the tentative refund year.

Review of the Temporary Procedures

On April 17, 2020, the IRS began to accept faxed Forms 1139 and 1045 for eligible refund claims under sections 2303 and 2305 of the CARES Act in order to quickly process NOL carryback and AMT credit refunds before the IRS returns to normal operations. Section 2303 of the CARES Act requires a taxpayer with an NOL arising in a 2018, 2019, or 2020 tax year to carry such loss back to the five preceding years unless the taxpayer elects to waive or reduce the carryback. Rev. Proc. 2020-24 sets forth procedures for taxpayers to make these elections. Section 2305 of the CARES Act allows a corporation to accelerate the recovery of remaining AMT credits to its 2019 tax year or to elect instead to recover its remaining AMT credits in its 2018 tax year.

Because the IRS cannot process a Form 1139 or Form 1045 that does not match the taxpayer's originally filed Form 1120, *U.S. Corporation Income Tax Return*, Form 1040, *U.S. Individual Income Tax Return*, or previously processed amended return information, the IRS will not process faxed Forms 1139 or 1045 under these procedures until it has processed the taxpayer's original or amended return for the year. The updated FAQs stress that a taxpayer should not fax an amended return at the time of faxing Form 1139 or Form 1045. Thus, if a taxpayer has not yet filed an original return or is required to file an amended return for the year, such return must be processed and reflected in the taxpayer's account before the IRS will process a tentative refund. Note, however, that Notice 2020-26 extended the time by which taxpayers can file a timely Form 1139 or Form 1045 for 2018 to December 31, 2020, and FAQs provide an extension to July 27, 2020 for fiscal year 2017.

Interaction with Section 965 Inclusion Years

The FAQs advise that a taxpayer may disregard the instructions for Forms 1139 and 1045 which prohibit taxpayers from using these forms to apply for refunds for section 965 inclusion years, and that the instructions to these forms will be updated to reflect this change. However, there is at least one situation where the temporary procedures for faxing such forms is complicated for a section 965 inclusion year, as illustrated in question 10 of the Frequently Asked Questions About Carrybacks of NOLs for Taxpayers Who Have Had Section 965 Inclusions, issued in conjunction with these FAQs.

> Q10. I carried back an NOL arising in 2018 solely to non-section 965 years (in this case, 2013, 2014, 2015, and 2016), and made an election to exclude 2017, my section 965 year, from the carryback period. I also previously made a timely section 965(h) election to pay my section 965

net tax liability for 2017 in installments. The NOL was fully absorbed in pre-section 965 years. As a result of the carryback of the NOL to pre-section 965 years, there is a change in tax attributes (such as a foreign tax credit carryover or charitable contribution carryover) for 2017. The change in tax attributes reduces, but does not eliminate, my section 965 net tax liability for 2017. Should I file an amended return for 2017 to reflect this?

A10. If you do not file an amended return, our records will not reflect the change in either the total tax liability or the section 965(h) net tax liability for the section 965 year due to the change in tax attributes. Consequently, your section 965(h) net tax liability and associated installment payments due in the future may not be accurately reflected in our systems. This, in turn, could lead to unintentional or erroneous accelerations of section 965(h) installment payments if you do not pay the pre-change installment amounts, as well as potential interest and penalty charges, delays in refunds, or other processing complications.

Do not use the temporary procedures reserved for submission of certain claims on Form 1139 or Form 1045 to fax your amended return. Amended returns and other submissions faxed to the temporary fax number will not be processed.

Key Takeaways

The above question illustrates several key points:

- Where there is a change in tax attributes (like a foreign tax credit carryover) for a tentative refund year, the taxpayer may not see an immediate benefit from the temporary faxing procedure for such year, and instead will need to first file an amended return;
- The taxpayer must file an amended return consistently with the normal filing instructions;
- The IRS must process the amended return before processing Form 1139 or Form 1045;
- Taxpayers may fax Form 1139 or Form 1045, taking note of the 100-page length restriction and other instructions provided in the FAQs;
- The IRS generally has 90 days to process an eligible refund claim resulting from Form 1139 or Form 1045; and
- The IRS is quickly issuing FAQs that are subject to change and upon which taxpayers may place limited reliance. See our article addressing this subject, above.

Taxpayers should consider that amended returns and Forms 1139 and 1045 may be subject to review by the Joint Committee on Taxation, depending on the amount at issue. Further, current law may be inconsistent with the positions taken on the original return. Where final regulations have been issued that are more unfavorable to an original reporting position, taxpayers should proceed cautiously if such positions could be open to IRS scrutiny.

By Elizabeth Boone, San Francisco

IRS's FAQs Provide Insights on Transfer Pricing Documentation Best Practices in Extraordinary Circumstances

On April 14, 2020, the IRS issued a list of frequently asked questions ("FAQs") in response to a June 2018 IRS Large Business & International ("LB&I") division directive and an IRS Advisory Council recommendation to promote higher quality transfer pricing documentation. Echoing the messages emanating from the FAQs, companies dealing with challenging circumstances posed by the COVID-19 pandemic may want to conduct a "self-assessment" of their transfer pricing compliance to proactively address concerns the IRS might raise in future audits.

Context for Best Practices

Although maintaining transfer pricing documentation is not explicitly required under the Code, a taxpayer has an increased risk of incurring a 20 percent to 40 percent penalty on a section 482 transfer pricing adjustment that exceeds the relevant dollar thresholds. A taxpayer could be exempted from this net adjustment penalty if it prepares adequate and timely transfer pricing documentation that satisfies the requirements under Treas. Reg. § 1.6662-6. In addition to protection against penalties, the IRS also believes that proper transfer pricing documentation may increase "the potential for deselection of issues earlier in the examination process" and "sav[es] both the taxpayer and the IRS time examining low-risk transfer pricing issues." The FAQs caution, however, that taxpayers must articulate more focused and useful information in their documentation. Inadequate, incomplete, or untimely production of documentation will not facilitate efficient transfer pricing audits or risk assessments for either taxpayers or examiners.

Overview of FAQ Documentation Best Practices

Citing the IRS's observations of common mistakes, the FAQs in a non-exclusive list categorize areas in documentation that could be improved to support adequately the reasonableness of the taxpayers' selection of transfer pricing method and the manner in which they apply it. An overarching theme of the FAQs appears to be a desire for additional detail, analysis, and support in the documentation relating to all aspects of the taxpayer and its intercompany transfer pricing. For instance, the FAQs suggest that a summary of all of the taxpayer's intercompany transactions at the beginning of transfer pricing documentation "can help focus review and examination on the most significant transactions."

As another example, the FAQs make clear that the industry and company analyses in the documentation should not be window dressing. Rather, the taxpayer should "tell its story" and provide context for related-party transactions, including any economic downturns that the industry is experiencing or other unforeseen special business circumstances that affect the transfer pricing results. The FAQs likewise recommend that the functional analysis in the documentation be well supported and not rely on broad assumptions about the business and industry, and that the allocation of risk between controlled parties be addressed and supported, with an emphasis on intercompany policies or agreements supporting such allocation.

Similarly, the FAQs cite, among other common errors, inadequate comparability analyses that fail to support any adjustments to the comparables and suggest that taxpayers include a thorough analysis of how and why comparability adjustments were selected and applied, including whether the adjustments were rational and consistent. The FAQs also advise that both the selection of the best method and the profit level indicator ("PLI") be substantively supported beyond simple conclusory statements, along with a reasoned basis for the rejection of other specified methods.

Among the recommendations in the FAQs is also a suggestion to taxpayers to consider conducting a "self-assessment" or sensitivity analysis around the various parameters used in the transfer pricing analysis. This analysis should include, for instance, evaluating the strength of the comparability analysis and the benchmark companies (e.g., reevaluating the analysis if removal of one comparable causes the tested party's results to fall outside the benchmark range), comparing the tested party's results against a variety of PLIs and being prepared to address potential inconsistencies between PLI results, and evaluating the reasonableness of how system profits are shared between related parties.

Overall, the IRS intends these recommendations to lead to more robust transfer pricing documentation and, correspondingly, a more efficient transfer pricing assessment and examination for both taxpayers and the IRS.

Relevance of the New FAQs for Responding to Crisis

Although not specifically targeted to businesses responding to the COVID-19 crisis, the FAQs nonetheless offer insightful illustrations of how a taxpayer could articulate solid and cogent transfer pricing positions on its losses relating to extraordinary circumstances in well-prepared documentation. This provides useful guidance for preparing documentation by companies impacted by the current COVID-19 crisis.

In one example discussed in the FAQs, a US company distributes heavy machinery it purchases from its foreign parent and expects to earn a return of X% of sales under normal business circumstances. In 2017, the year under audit, the US distributor had significant losses. The FAQs note that these losses may be an initial indicator of incorrect intercompany prices under normal business circumstances. However, during 2017, the demand for the company's heavy machinery dropped unexpectedly, and the US distributor sold fewer machines than anticipated, resulting in losses for the US distributor. Because the loss was caused by an unexpected change in the company's business circumstances, and not by non-arm's length intercompany prices, the FAQs suggest that the transfer pricing documentation of the company should thoroughly explain how the unforeseen business circumstances experienced by the company, rather than intercompany prices, caused the losses. Accordingly, companies experiencing losses a result of COVID-19 and/or the current economic environment should memorialize these unusual situations in their documentation to demonstrate that unforeseen circumstances caused any losses, and not inappropriate transfer pricing.

Notably, the IRS warns against "manipulat[ing] [the] set of comparable companies" used in the transfer pricing analysis to benchmark the losses experienced by the US company. Under the facts above, the IRS cautioned against using companies that are not truly comparable to the US distributor to cause the results of the distributor to fall within the interquartile range of comparable company profitability. According to the IRS, taxpayers adopting such an analysis in its documentation will "considerably lengthen" the audit period and burden the taxpayer with additional requests for information. Despite this pronouncement, and particularly for companies experiencing negative impacts as a result of the current economic and global environment, it will nevertheless be an important exercise to revisit the comparables comprising the comparability analysis to ensure that they in fact remain comparable and are facing similar economic conditions or business disruptions as the tested party. Any such changes to the comparables, however, should be fully justified and addressed in the documentation.

Further Reflections

With the economic distress that companies may be experiencing as a result of COVID-19, and the corresponding changes that companies may be adopting to address the global crisis, companies should consider how to present and support the present economic and operational circumstances, relevant financial results, and any operational/transfer pricing changes to the IRS and other auditors. Transfer pricing documentation provides an initial platform and an opportunity from which companies can develop the information necessary for an audit. Companies are encouraged to review their transfer pricing compliance and ensure they adequately support not only the potential changes to the financial results but also the conditions precipitating the changes in preparing their contemporaneous documentation. In the meantime, companies should not shy away from reassessing a comparability analysis where the comparable companies and the tested party face varying economic distress or business disruptions created by COVID-19 and react differently. Further, documentation is the first step, and companies should prepare to defend any changes set forth in the documentation in a forthcoming IRS examination.

By Amanda Worcester-Martin, Vivek Patel and Winna Li, Washington, DC

2019 APMA APA Statistics Show Improvement

On March 25, 2020, the IRS issued its Announcement and Report Concerning Advance Pricing Agreements (*Announcement 2020-2, 2020-15 I.R.B. 609 (April 6, 2020)*) (the "2019 APA Report"), which presents the key results of the IRS's Advance Pricing and Mutual Agreement Office ("APMA"). The 2019 APA Report provides general information regarding the operation of the office, including staffing, and statistical information regarding the numbers of APA applications received and resolved during the year, including demographics of companies involved, demographics of countries involved, industries covered, and transfer pricing methods ("TPMs") employed. The following article summarizes the highlights of the report and provides observations based on our experience with APMA and APAs, both within the program and as counsel to companies in the program.

APA Filings

Not surprisingly, the number of new APA filings decreased significantly from 203 in 2018 to 121 in 2019. This likely was due to companies strategically filing for APAs in 2018 before the APA user fee hikes effective on July 1, 2018, and January 1, 2019. That said, the number of APA filings in 2019 was largely consistent with the number of annual filings since 2011 (the major anomaly other than 2018 was 2015 when companies filed APA requests before compliance requirements under Rev. Proc. 2015-41 came into effect). Additionally, the number of multilateral APAs filed in 2019 increased again compared to 2018 (eight vs. seven, respectively), which combined is more than double the number filed from 2000 through 2017 (eleven). There are potential efficiencies created by resolving transfer pricing issues in several countries simultaneously, including from the taxpayer's perspective, the possibility of avoiding audits of APA transactions (depending on local country rules).

APA Processing

The overall APA inventory in 2019 notched down slightly compared to 2018 (454 and 458, respectively), despite the government shutdown that covered most of January 2019. The number of bilateral APAs pending was nearly the same as in 2018 (387 and 386), while the unilateral APAs pending decreased (from 58 to 46). Japan (28%), India (21%), Canada (10%), Germany (8%), and Korea (5%) constituted the majority of the pending bilateral APAs, which was largely consistent with 2018. The report also included the number of pending bilateral APAs involving Mexico (5%), the UK (4%), Italy (4%), and all other countries (15%). There were 22 multilateral APAs pending in 2019 compared to 13 in 2018, which is a significant increase.

For APAs executed in 2019, renewal APA processing times showed improvement, but new APAs took about the same time as in 2018. Bilateral APAs executed in 2019 required less time to complete compared with 2018 (40.5 months (median) compared with 42.1 months (median)). Not surprisingly, APAs requiring the shortest processing times were unilateral APA renewals (30.7 months (median)). As indicated in the 2019 APA Report, of the 18 different measures of processing time (e.g., average vs. median months, unilateral vs. bilateral APA, new vs. renewal APA), all but two measures showed improvement in 2019 compared with 2018. This was accomplished while having the same number of APMA personnel as in 2018 (though with four fewer team leaders and four more economists).

Additionally, APMA released the “functional cost diagnostic model” (“FCDM”) in 2019, which is intended to evaluate whether a one-sided method is the best method for the covered issue(s). The FCDM is complex and requires additional time and resources to apply (and may be contrary to positions held by companies and/or treaty partners), and it is likely that those cases in which APMA requests an FCDM analysis may face higher processing times. However, the FCDM did not appear to increase processing times in 2019. Perhaps the APAs executed in 2019 were too far along in the negotiation process for APMA to require an FCDM analysis. It remains to be seen how widespread use of the FCDM will be going forward.

APA Terms

APA term lengths, including rollback years, averaged six years in 2019 (down from seven years in 2018 and 2017). The largest number of APAs were executed with five-year terms (44% of the total) and 86% had terms of five or more years. In addition to the impact of aging inventory, long APA terms can be a product of complex issues, difficult competent authority negotiations, and the desire for prospective coverage. In 2020, it is possible that the impact of COVID-19 may limit companies', or treaty partners', desire to extend proposed APA terms.

TPMs Applied

For 2019, the comparable profits method/transactional net margin method ("CPM/TNMM") continued to be the most commonly applied TPM for tangible and intangible property transactions (applied to 81% of such transactions). Regarding the profit level indicator ("PLI") used when the CPM/TNMM is employed, the operating margin (defined as operating profit divided by net sales) was applied 64% of the time – continuing to decline from 85% in 2017 and 68% in 2018. The Berry ratio, return on assets, or other PLIs were applied in the remaining cases, and the 2019 APA Report, unlike pre-2016 reports, does not separately state the number of times that PLIs other than the operating margin were used.

For services transactions, the CPM/TNMM also was the most common TPM with the operating margin or markup on total costs being used as the PLI for a combined 65% of the services transactions. These two PLIs were used a combined 11% less than in 2018.

Conclusion

The streamlined intake processes and the increase in information required by Rev. Proc. 2015-41 was intended to reduce processing time by ensuring APMA started with the information it needed. The effects of these changes perhaps began to bear fruit in 2019 with the general decrease in processing times and slight decrease in inventory. Further, APMA opened its hiring process in early 2020, which potentially could help to further decrease processing times and to alleviate some of the 2018 inventory spike noted above. However, while APMA has been working from home during the pandemic, it is likely that APA processing times around the globe could increase in 2020 due to a general slowdown in negotiations with many treaty partners. Only time will tell the full impact of COVID-19 on APAs (for further insight *see* *APAs: The Quest for Certainty in Times of Uncertainty*).

By Donna McComber and Kent Stackhouse, Washington, DC

DAC6 Reporting Deadlines Relaxed in Response to Pandemic

On May 8, 2020, the EU Commission released its *Council Directive Amending Directive 2011/16/EU to Address the Urgent Need for Deferring Certain Time Limits for the Filing and Exchange of Information in the Field of Taxation Due to the COVID-19 Pandemic*, which proposes to member states a three-month delay to all deadlines for DAC6 reporting. The proposal also provides for an additional three-month deferment if necessary. The proposal came shortly after certain member states and several major financial institutions requested reporting delays, citing to COVID-19-related concerns regarding the ability of taxpayers and intermediaries to meet reporting deadlines and the capacity of tax administrations to process the information.

Key Reporting Dates

Two distinct periods are considered under DAC 6 for the reporting of reportable transactions by intermediaries or taxpayers. Under the proposal, these periods would be adjusted as follows:

- **The "Look-back Period":** the period between June 25, 2018 and June 30, 2020 for which reporting would be due by November 30, 2020; and
- **The "Business-as-Usual Period"**: which would include both
  - the period from July 1, 2020 to September 30, 2020 which would be subject to delayed reporting and due on October 31, 2020 (i.e., "within 30 days" of October 1, 2020); and
  - any period after July 1, 2020 that is not affected by a reporting delay, for which the reporting is due within 30 days.

Similarly, member states would have three additional months for the first automatic exchange of information on reportable cross-border arrangements, with reporting deferred until January 31, 2021.

Note that if an additional three-month deferral is granted, these dates would change.

For a more detailed overview of implementation of the delayed deadlines, please see our recent client alert. For more background information on DAC6, see DAC6: The EU's Mandatory Disclosure Regime.

By Elizabeth Boone, San Francisco

IRS Announces TCJA Compliance Campaign

On May 1, 2020, IRS Large Business and International ("LB&I") announced its *new compliance campaign* focused on the Tax Cuts and Jobs Act ("TCJA"), stating as follows:

> The Tax Cuts and Jobs Act (TCJA) was signed into law on December 22, 2017. Taxpayers have filed returns for 2017 and 2018 and are in the process of preparing and filing 2019 returns. In 2020, the majority of returns that will be under review by LB&I will be returns reflecting changes brought about by TCJA; and in light of that, LB&I has initiated the TCJA Campaign to closely monitor issues on a select pool of returns and share information learned throughout LB&I and the IRS. LB&I is also considering the

impact of the Coronavirus Aid, Relief and Economic Security (CARES) Act on these returns as well as any others examined. The goal of this campaign is to identify transactions, restructuring and technical issues and better understand taxpayer behavior under the new law. The treatment streams for this campaign may include examinations, soft letters, outreach, new and improved practice units and development of future issue-based campaigns.

This is just one of the many new compliance campaigns LB&I has "identified, approved, and launched" since it announced the 13 initial campaigns on January 31, 2017.

By Donna McComber and Kent Stackhouse, Washington, DC

Some Planning Opportunities for Families Amidst Crisis

On April 29, 2020, the United States Bureau of Economic Analysis ("BEA") released data showing that the United States economy shrank in Real GDP terms at a 4.8% annualized pace in the first quarter of 2020. At the same time, the International Monetary Fund reported the Real GDP slide in the United States was even higher. In response to this economic decline, the United States Federal Reserve reduced its target federal funds interest rate on March 16, 2020, with the benchmark United States Treasury 10-year bond hitting a record low yield on March 9, 2020. This has resulted in the IRS reducing the Applicable Federal Rate ("AFR") to record lows. While this might not be welcome news as a whole, it does present an opportunity for certain families to take advantage of the currently depressed fair market valuations and record low interest rates from a US gift and estate tax perspective, which is discussed with more detail in the following client alert, "*Some Family Planning Opportunities Amidst Crisis*."

By Daniel Hudson, Miami

IRS Provides COVID-19 Relief for Tax Deadlines and Tax Payments and 60-Day Relief for Foreign Nationals' Days of Presence

The IRS has provided relief to taxpayers with tax returns and tax payments due April 15, 2020, in the form of a series of Revenue Procedures extending the due dates of the tax returns and tax payment. The due dates are generally extended to July 15, 2020, but the date in some cases may be different.

The IRS has also expanded the medical condition exception to the substantial presence test for foreign national individuals whose US tax residency status may be impacted by the travel disruptions, border closings, and other shelter-in-place orders related to COVID-19.

For additional information, please see Baker McKenzie client alerts, "*COVID-19 - Tax, Immigration and Social Security Implications for Mobile Individuals*" and "*United States: Asked and Answered, IRS Expands Medical Condition Exception to Include US Days of Presence Related to COVID-19*."

By Ceci Hassan, Miami

State and Local Tax - COVID-19 Updates

The Baker McKenzie State and Local Tax Subpractice group has published a number of updates on the state and local tax effects of COVID-19. Recent blog posts have addressed nexus and apportionment relief for employers with telecommuting employees, as well as the latest extensions of corporate income tax and sales and use tax deadlines.

For more information on these and other recent state and local tax updates, please see "*State and Local Tax Responses to COVID-19: Nexus and Apportionment Relief for Employers With Telecommuting Employees [Updated April 22, 2020]*" and "*State and Local Tax Responses to COVID-19: Corporate Income Tax and Sales and Use Tax Deadline Extensions [Updated May 3, 2020]*" on the SALT Savvy blog, available at www.saltsavvy.com.

By Dmitrii Gabrielov, New York

OECD Races Toward Completing Final Report on Digital Economy

Taxpayers have limited time to include their practical perspectives in the largest reshaping of the international tax system in a generation. On the heels of the US's Tax Cuts and Jobs Act ("TCJA"), the Organisation of Co-Operation and Economic Development ("OECD") continues to target an end of 2020 "consensus solution" of a how to tax multinationals in the new economy ("Pillar One"), including the design of a backstop global minimum tax measure ("Pillar Two"). Both Pillars are stunning in their scope as they not only affect newer digital economies, but have ramifications for all multinationals. Moreover, US multinationals should be cognizant that this unprecedented tax system roll-out, similar to experiences with the TCJA, will run into practical complexities and nuances that will multiply the controversies in all OECD jurisdictions. This article looks to recent experiences of the TCJA and the OECD's Pillar One on the upcoming challenges in this sprint to develop Pillar Two, and encourages multinationals to actively engage with their policy-makers to avoid foot faults in the design of the future international tax system."

For a more thorough discussion, please refer to the following article, "*OECD Races Toward Completing Final Report on Digital Economy*" published by TEI Magazine (available at www.bakermckenzie.com).

By Gene Tien, Palo Alto

IRS Private Ruling: Modifications to Trust Agreement and Creation of Successor Trusts Did Not Cause Trust to Lose GST Tax Exemption

In five private letter rulings released on March 27, 2020, the IRS took the position that proposed modifications to a trust agreement and the creation of successor trusts would not cause a trust or the successor trusts to lose their exemption from the generation-skipping transfer ("GST") tax. The IRS issued 5 identical private letter rulings in response to what appears to have been a joint inquiry made by five interested and related parties. The facts and circumstances which led to the issuance of the private letter rulings are particularly interesting and illustrative of the GST tax rules as the initial transfers to trust occurred before September 1985. The IRS's rulings illustrate a consideration and application of both the transitional rules and general rules of the GST tax. The GST tax can pose particular tricky and unforeseen tax issues to those administering and benefitting from trusts that may fall within the purview of GST tax transitional rules. The GST tax should be considered whenever a generation-skipping transfer is being planned or deemed to occur. While the facts that gave rise to the PLRs discussed above involve a trust, a generation-skipping transfer can also occur as outright gift transfers, transfers by will, or a combination of all three.

For additional information, please see Baker McKenzie client alert, "*IRS Private Ruling: Modifications to Trust Agreement and Creation of Successor Trusts Did Not Cause Trust to Lose GST Tax Exemption*."

By John Cacharani, Zurich

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COVID-19: Saudi Arabia Triples VAT Rate to 15%

The Kingdom of Saudi Arabia ("KSA") has announced that it will triple the rate of VAT to 15%, effective on July 1, 2020. This is a significant rate increase and one of the fiscal measures taken by the KSA government to mitigate the negative effects of the COVID-19 pandemic and other macro-economic developments in public finance. The increased rate is expected to apply to all supplies of goods and services that are currently subject to the 5% VAT rate.

For additional information, please see Baker McKenzie client alert, "*COVID-19: Saudi Arabia Triples VAT Rate to 15%*."

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