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Tax News and Developments
North America Tax Practice Group

Newsletter

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Residual Profits and Market Jurisdictions

The OECD/G20 Inclusive Framework on BEPS ("Inclusive Framework"), composed of 139-member countries, has been working on a consensus-based, long-term solution to the tax challenges arising from globalization and the digitalization of the economy. During its January 29-30, 2020 meeting, the Inclusive Framework decided to move ahead with a two-pillar approach, including: under the first pillar, solutions for determining the allocation of taxing rights, and under the second pillar, the design of a system to ensure that multinational enterprises ("MNEs") pay a minimum level of tax on profits. These two pillars were fleshed out in greater detail in October 2020. Pillar One reallocates taxing rights over the residual profits of the largest and most profitable MNEs away from the locations where they actually operate to market jurisdictions. Pillar Two attempts to introduce a global minimum corporate tax that countries can use to protect their tax bases.

While both pillars have generated a tremendous amount of interest in the international tax community, Pillar One holds the greatest fascination. It is a new concept in international tax albeit with limited applicability. In contrast, Pillar Two borrows heavily from the US tax reform enacted in December 2017. The Income Inclusion Rule ("IIR") in Pillar Two is closely related to the Global Intangible Low-Taxed Income ("GILTI") regime, and the Undertaxed Payments Rule ("UTPR") is related to the Base Erosion and Anti-abuse Tax ("BEAT").

In April 2021, the US Treasury made a presentation to the Inclusive Framework as to Pillars One and Two. The OECD had earlier proposed that only certain automated digital services and consumer-facing businesses would be potentially impacted by Pillar One. In its presentation, the Treasury stated that no more than 100 MNEs should be in scope (i.e., be subject to Pillar One). Instead of the original scope definition based on sector, Treasury proposed that quantitative criteria should be utilized in determining which MNEs are in scope, and that criteria should be a "total revenue threshold" and a "profit margin threshold." Treasury noted that a total revenue threshold is easily applied and eliminates many MNE groups. A profit margin threshold, according to Treasury, identifies the most intangible driven and the most profitable MNEs with the highest profit-shifting potential.

In response to a May 24, 2021 letter from Senator Michael Crapo (R-ID), Ranking Member of the Senate Finance Committee, Treasury Secretary Janet Yellen wrote in her letter dated June 4, 2021, that "Meanwhile, our Pillar 1 comprehensive scope proposal will be largely revenue neutral for the United States since we will be on both the receiving and giving end of the proposed profit reallocations. Indeed, one interesting feature of Pillar 1 estimates is that

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they demonstrate the extent to which both US- and foreign-headquartered corporations have managed to shift profits derived from sales to US customers outside the United States for years, including under the 2017 tax act."

The G-7 Finance Ministers met in London on June 4-5, 2021. They agreed to award taxing rights on at least 20 percent of the residual profits, that is above a 10 percent margin, for the largest and most profitable multinational entities to market jurisdictions. And they agreed to a global minimum tax of at least 15 percent that each country would adopt.

The 139 member-countries of the Inclusive Framework met virtually on June 30-July 1, 2021. At the conclusion of their meeting, they released a statement supported by 130 (currently, 132) of its members that, if enacted and implemented by the member-countries, would dramatically change international tax around the world. The Inclusive Framework statement provided as to Pillar One:

> **Scope**
> In-scope companies are the multinational enterprises (MNEs) with global turnover above 20 billion euros and profitability above 10% (i.e. profit before tax/revenue) with the turnover threshold to be reduced to 10 billion euros, contingent on successful implementation including of tax certainty on Amount A, with the relevant review beginning 7 years after the agreement comes into force, and the review being completed in no more than one year. Extractives and Regulated Financial Services are excluded.
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> **Nexus**
> There will be a new special purpose nexus rule permitting allocation of Amount A to a market jurisdiction when the in-scope MNE derives at least 1 million euros in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than 40 billion euros, the nexus will be set at 250 000 euros. The special purpose nexus rule applies solely to determine whether a jurisdiction qualifies for the Amount A allocation. Compliance costs (including on tracing small amounts of sales) will be limited to a minimum.
>
> **Quantum**
> For in-scope MNEs, between 20-30% of residual profit defined as profit in excess of 10% of revenue will be allocated to market jurisdictions with nexus using a revenue-based allocation key.

The G-20 Finance Ministers met in Venice on July 9-10. In its Communique released at the end of their meeting, the G-20 Finance Ministers wrote:

> We endorse the key components of the two pillars on the reallocation of profits of multinational enterprises and an effective global minimum tax as set out in the 'Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy' released by the

> OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("BEPS") on July 1. We call on the OECD/G20 Inclusive Framework on BEPS to swiftly address the remaining issues and finalise the design elements within the agreed framework together with a detailed plan for the implementation of the two pillars by our next meeting in October.

Since the release of the Inclusive Framework statement on July 1, a couple of reports have surfaced on the impact of Pillar One. Nikkei, using earnings data from QUICK FactSet, determined that 81 companies meet the revenue and profit margin thresholds set out in the Inclusive Framework statement. Of those 81 companies, 35 are American companies, 11 are mainland Chinese companies, six are Japanese companies, and five are Hong Kong companies. Nikkei Staff Writers, *China and US home to nearly 60% of companies likely to pay global tax* (July 3, 2021).

Michael Devereux and Martin Simmler, both of Oxford, recently published "Who Will Pay Amount A?" in EconPol Policy Brief (July 2021). Devereux and Simmler found that only 78 of the world's 500 largest companies will be affected by Amount A in Pillar One. If the lower end — 20 percent — of the residual profit allocation is adopted, then the total allocation of Amount A for these 78 companies would be $87 billion. Of that amount, $56 billion would be generated by US-headquartered companies, $39 billion by technology companies and $28 billion by the five largest US technology companies (Apple, Microsoft, Alphabet, Intel and Facebook). Devereux and Simmler noted that the smallest of the 500 largest companies has revenues of $26.3 billion. As a result, Devereux and Simmler speculate that if a revenue threshold of $20 billion is utilized, in-scope companies and Amount A might be around 100 companies and $100 billion, respectively.

By: Christopher Hanna, Dallas

G20 Supports Latest Pillar One and Pillar Two Proposals

On July 10, 2021, the G20 finance ministers endorsed the key components of the two-pillar proposals to address today's tax challenges. The revised version of Pillar One, which deals with the re-allocation of taxing rights, will affect the world's largest and most profitable companies (global turnover in excess of EUR 20 billion and a profit margin of at least 10%). Pillar Two, which introduces a global minimum effective tax rate of at least 15%, will apply to all MNEs with a global turnover of at least EUR 750 million.

While the G20 endorsement of the revised proposals was expected, the formal seal of approval from the G20 finance ministers is an important milestone for the two-pillar solution, giving the proposals further impetus.

G20 Announcements

The finance ministers of the G20 nations announced on Saturday July 10th that they have endorsed the revised proposals as presented in the July 1, 2021 "Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy" published by the OECD Inclusive Framework.

The G20 finance ministers have also invited the members of the OECD Inclusive Framework ("OECD IF") who have not yet joined the agreement to do so. In its communiqué, the G20 also urged the OECD IF to address any remaining issues and to draft a detailed plan for implementation before the next G20 meeting in October.

The Revised Proposals

Pillar One will introduce measures to re-allocate taxing rights of residual profits of large multinationals. The aim of Pillar One is to tax profits in the jurisdiction where revenue is sourced. While the October 2020 Blueprint originally limited the scope of Pillar One to multinationals ("MNEs") operating in Automated Digital Services ("ADS") and Consumer Facing Business ("CFB") industries, the OECD IF agreed on the wider scope as proposed by the Biden administration in April 2021. The wider scope of Pillar One will affect businesses with a global revenue of at least EUR 20 billion and a net profit margin in excess of 10%. According to the proposal, after 7 years, the scope could be broadened to cover a global revenue threshold of at least EUR 10 billion, conditional upon successful implementation, including regarding certainty of Amount A. The net profit margin of 10% is not anticipated to change. By limiting the scope of Pillar One to only MNEs with a very significant global revenue threshold, while at the same time extending the industry scope, Pillar One will likely target the top 100 or so largest and most profitable companies in the world. The extractives and regulated financial services industries remain out of scope of Pillar One.

Pillar Two will introduce a global minimum effective tax rate of **at least** 15% by introducing Global Anti-Base Erosion ("GloBE") rules to ensure that all profit of MNEs is "adequately" taxed. GloBE rules will apply to all MNEs with a global turnover in excess of EUR 750 million. The international shipping industry is excluded from Pillar Two.

The GloBE rules will have the status of a common approach among OECD IF members, meaning that the members will not be required to implement GloBE rules, but should the member choose to do so, the GloBE rules should be administered in a way that is consistent with Pillar Two. The adoption of Pillar Two by an overwhelming majority of jurisdictions will likely change the international tax landscape dramatically. The OECD IF statement says members "would implement" the subject-to-tax rule ("STTR") into their bilateral treaties with developing IF members when requested to do so.

Within the EU, it may be challenging to implement the revised Pillar Two proposal by way of an EU Directive as at least two EU member states (i.e., Hungary & Ireland) have, so far, disagreed with the proposed rate, and Estonia also has expressed reservations. The proposed EU Directive would require unanimous consent, assuming the EU cannot find a legitimate basis to implement Pillar Two through a qualified majority voting approach.

What is still unclear?

While a lot of details about the proposals have been released, a lot remains uncertain.

For Pillar One, uncertainty remains about the sourcing rules. It is unclear whether the marketing & distribution revenue will be considered in scope of a "safe harbour" reducing exposure to Amount A, when MNEs already allocate a significant amount of marketing & distribution activities to a source jurisdiction in accordance with current transfer pricing rules.

For Pillar Two one of the key questions remains as to how the GloBE rules will co-exist with the US GILTI regime. In light of the current legislative initiative relating to GILTI, the OECD IF agreement states that "consideration will be given to the conditions under which the US GILTI regime will co-exist with the GloBE rules, to ensure a level playing field." Those conditions would likely take into account whether the GILTI rate ends up below 15% and whether GILTI continues to be applied on a jurisdiction by jurisdiction basis. Another key question is how the GloBE rules will co-exist with an OECD-approved patent box regime.

Tax compliance is an issue for both pillars. For Pillar One, it appears that the OECD IF agreement is envisaging a streamlined process in which a single entity within an MNE could manage the process. This does not necessarily involve a "one stop shop" where the competent authority of the parent entity would act as a central filing location or a "paymaster" or main tax collector for the additional Pillar One tax revenue, and OECD officials have since said centralization of payment is not a realistic option. The nature of simplification options for Pillar Two compliance remains undecided.

Next Steps

All eyes return to the OECD's Inclusive Framework, which is scheduled to meet again in October to adopt a final version of the agreement that is supposed to resolve the outstanding issues, as well as an implementation plan and timeline. The general intention is to have a Multilateral Convention ready for signing in 2022. The implementation of the Pillars One and Two proposals is scheduled for 2023, according to the OECD IF agreement. This date seems extremely ambitious, especially in light of the number of details that have yet to be worked out, and it remains to be seen whether the ambitious goal will be met.

By: Mounia Benabdallah, New York, Mary Bennett, Washington, DC and Kate Alexander, London

Eleventh Circuit Agrees that the Federal Circuit Effectively Has Control Over All Overpayment Interest Suits

In April 2021, the Eleventh Circuit issued an opinion in *Paresky v. US*, holding that district courts do not have jurisdiction pursuant to 28 U.S.C. §1346(a)(1) to overpayment interest suits, and such jurisdiction is limited to the Court of Federal Claims granted to them under 28 U.S.C. §1491 (also known as the "Tucker Act").

Statutory Background

Section 1346(a)(1) grants concurrent jurisdiction to district courts and the Court of Federal Claims for (1) any civil action for the recovery of tax alleged to have been erroneously or illegally assessed or collected, (2) any unauthorized penalty collected, or (3) "any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws." Section 1346(a)(2) (commonly referred to as the "Little Tucker Act") grants concurrent jurisdiction to the district court and the Court of Federal Claims for any other civil action or claim against the United States not exceeding $10,000 in amount.

On the other hand, section 1491(a)(1) grants jurisdiction to the Court of Federal Claims for any monetary claim against the United States that is founded either upon the Constitution, an Act of Congress, a regulation of an executive department, an express or implied contract, or for liquidated or unliquidated damages in cases not sounding in tort.

Court of Federal Claims

In September 2017, the Pareskys, victims of Bernie Madoff's Ponzi scheme, filed a complaint in the Court of Federal Claims, arguing that the government owed them overpayment interest relating to their 2003 through 2007 tax years. The IRS moved to dismiss the Pareskys' complaint, arguing that the Tucker Act, 28 U.S.C. § 1491, provides the Court of Federal Claim with jurisdiction "to render judgment upon any claim against the United States founding either upon the Constitution, or any act of Congress," but that the Pareskys failed to file their complaint within the six-year limitations period for claims under the Tucker Act.

The Court of Federal Claims found that it lacked jurisdiction because the Pareskys' claim was untimely under the Tucker Act. It granted the Pareskys' motion to transfer the case to the Southern District of Florida as it was "not evident how the Southern District of Florida or [this Court] would address jurisdiction over a standalone claim for overpayment interest."

Southern District of Florida

The Pareskys filed an amended complaint, arguing that the district court had jurisdiction under sections 1346 and 1491; while the government moved to dismiss under FRCP 12(b)(1) – arguing lack of jurisdiction, or alternatively, even if there were jurisdiction, the Pareskys failed to timely file administrative claims.

The Magistrate Judge for the Southern District of Florida concluded in its Report and Recommendation that that the district court had jurisdiction over a claim for overpayment pursuant to section 1346(a)(1), relying on the Sixth Circuit's decision in *E.W. Scripps Co. v. United States,* 420 F.3d 589 (6th Cir. 2005). In *Scripps*, the Sixth Circuit found that the phrase "any sum" in section 1346(a)(1) includes overpayment interest. However, because the Pareskys had not timely filed their administrative claims with the IRS for their 2003-2006 tax years, the Magistrate Judge recommended the overpayment interest claim as to those tax years be dismissed for lack of subject matter jurisdiction.

Both parties filed separate objections to the Magistrate's Report and Recommendation. The district court ultimately issued an order declining to adopt the Report and Recommendation, and dismissed the Paresky's amended complaint for lack of subject matter jurisdiction. The district court explained in its order that during the objections period of the case at hand, the Second Circuit issued its decision in *Pfizer Inc. v. United States*, 939 F.3d 173 (2d Cir. 2019), which disagreed with the Sixth Circuit's decision in *Scripps*. The Second Circuit held that overpayment interest suits lie exclusively within the jurisdiction of the Court of Federal Claims. The district court found the analysis in *Pfizer* to be "more reasoned and persuasive" while *Scripps* relied upon an overbroad reading of dicta.

The Pareskys moved for reconsideration of the district court's order and filed their notice of appeal with the Eleventh Circuit. The district court denied the motion for reconsideration and entered judgment for the government.

Eleventh Circuit

Both parties appealed to the United States Court of Appeals for the Eleventh Circuit. The Eleventh Circuit reviewed the district court's legal conclusions *de novo*. On appeal, the Pareskys urged the court to follow the reasoning of the Sixth Circuit in *Scripps*, while the government argued that the court should follow the reasoning of the Second Circuit in *Pfizer*.

The Eleventh Circuit affirmed the district court's dismissal of the Pareskys' amended complaint. The court determined that Pareskys' claims for overpayment interest must fail because "overpayment interest" does not fall within any of the three exceptions under section 1346(a)(2) that grant concurrent jurisdiction to the lower district courts. Thus, jurisdiction for overpayment interest suits remains solely with the Court of Federal Claims.

Conclusion on Jurisdiction for Overpayment Interest Cases

In a 2020 case, *Bank of America* ("*BOA*") sued for overpayment interest the Western District Court of North Carolina. The district court held that it had jurisdiction under 28 § USC 1346(a)(1) under the "any sum" language. The government appealed the case to the Federal Circuit for a transfer of the case to the Court of Federal Claims. Ultimately, the Federal Circuit held that the Court of Federal Claims had exclusive jurisdiction on overpayment interest suits. Because of the Federal Circuit decision in *BOA*, all overpayment interest cases will now be restricted to the Court of Federal Claims and Federal Circuit unless and until the Supreme Court reverses *BOA*. For more details, see previous *Tax News and Developments* article, "Federal Circuit Effectively Assumes Control Over All Payment Interest Suits."

By: Christina Norman, Chicago

Ninth Circuit Reverses Tax Court's Use of Substance-Over-Form Doctrine in *Mazzei*

Following similar precedents from the First, Second, and Sixth Circuits, the Ninth Circuit Court of Appeals reversed a Tax Court opinion and held that the substance-over-form doctrine did not apply to make individual taxpayers, rather than those taxpayers' Roth IRAs, the owners of a Foreign Sales Corporation ("FSC"). As such, the funds received by the Roth IRAs were not excess contributions from the taxpayers subject to excise taxes.

The dispute centered around the taxpayers, members of the Mazzei family, and their company, Mazzei Injector Corp. Mazzei Injector Corp. actively exported product that added fertilizers to the water used in agricultural irrigation systems. The Mazzeis were also farmers and members of a trade association who represented farmers, the Western Growers Association ("WGA"). WGA promoted the use of FSCs by its members.

Congress created FSCs in 1984 as an alternative to the Domestic International Sales Corporation ("DISC"). DISCs were created by Congress for the express purpose of incentivizing American export companies. In preceding years, DISCs had become the subject of trade disputes, and Congress created FSCs to ameliorate international controversy. Eventually, FSCs themselves were found by the World Trade Organization to be impermissible subsidies, and Congress repealed FSC provisions in November 2000. But the repeal statute contained transition provisions that allowed existing FSCs to continue for a specified time. The statutory provisions governing FSCs had been set forth in former Code Sections 921 – 927.

The central premise of an FSC was that a company engaged in exporting goods could take a portion of the proceeds from export sales and contribute those proceeds to the FSC. A portion of the FSC's income attributable to those commissions was declared to be "exempt foreign trade income." That portion was treated as not effectively connected with the conduct of a trade or business in the United States, exempting that portion from taxation. The remaining income was subject to the corporate income tax rate without paying corporate income tax on the amount of the DISC commission. The export corporation was allowed to allocate a portion of its export sales income to the FSC by paying the FSC artificially determined commissions. The export company deducted the commissions as an expense, and paid no income tax on the commissions. The FSC paid income tax only on the non-exempt portion of its income attributable to the commissions.

Any entity may own shares in a FSC, and thus receive commissions from the FSC. Shares of a FSC may also be owned through traditional IRAs and Roth IRAs. Generally, unless otherwise specified in the Code, Roth IRAs are treated exactly the same as traditional IRAs. The most important distinction between the two types of IRAs is how contributions and distributions are treated. The Code sections that apply to traditional IRAs allow taxpayers to deduct their contributions, but taxpayers must pay tax on distributions from those accounts. In contrast, the taxpayers do not receive a deduction for contributions to Roth IRAs, but distributions from a Roth IRA are tax-free. Thus, a Roth IRA allows for the tax-free growth of their retirement account. In exchange for that benefit, Roth IRAs have a yearly contribution limit, and that limit phases out to zero based on the annual income of the Roth IRA owner.

The Mazzeis worked with WGA to set up their FSC, including entering into a commission agreement between the FSC and the Mazzeis' export company. The Mazzeis also each set up their own Roth IRA accounts. Each of the three Roth IRA accounts became a one-third shareholder of the FSC. Once this structure was in place, the FSC paid $533,057 in dividends to the Mazzeis' Roth IRAs between 1998 and March 2002. While the FSC paid some tax on the income attributable to its commissions, the Roth IRAs paid no tax on the dividends received from the FSC.

In 2009, the IRS issued notices of deficiency against each of the Mazzeis. The IRS asserted that the dividends paid by the FSC to the Roth IRA accounts were actually contributions from the Mazzeis to their Roth IRA accounts. The IRS assessed excise tax deficiencies totaling $108,282 against the three Mazzeis collectively, along with $31,127 in penalties. The three Mazzeis petitioned to the Tax Court.

The full Tax Court reviewed the case and upheld the excise tax assessment by a vote of 12-4, while unanimously setting aside the penalties. The Tax Court reasoned that the Roth IRAs' purchases of FSC stock did not reflect economic reality because the "Roth IRAs effectively paid nothing for the FSC stock, put nothing at risk, and from an objective perspective, could not have expected any benefits" from owning the FSC stock. For that reason, the Tax Court treated the

Mazzeis as the owners of the FSC stock and its dividends. Accordingly, the court determined that the contributions to the Roth IRAs came from the Mazzeis. Any contributions over the Roth IRA contribution limit in the relevant year were treated by the Tax Court as excess contributions subject to excise tax. The Mazzeis timely appealed to the Ninth Circuit.

On appeal, the Ninth Circuit reversed the Tax Court's decision, finding that the substance-over-form doctrine utilized by the Tax Court did not apply to the structure used by the Mazzeis. In some cases, "form—and form alone—determines the tax consequences of a transaction." The Ninth Circuit found that was the case with FSCs, which Congress expressly decreed can engage in transactions that lack economic substance.

In so finding, the Ninth Circuit relied heavily on three cases decided in the time frame between shortly before the Tax Court's decision in *Mazzei* and the Ninth Circuit's reversal. In these cases, the First, Second, and Sixth Circuits each reversed the Tax Court's decision in *Summa Holdings, Inc. v. Commissioner*, TC Memo 2015-119, 109 T.C.M. (CCH) 1612, 2015 Tax Ct. Memo LEXIS 125 (June 29, 2015). There, the Tax Court had utilized the substance-over-form doctrine to uphold excise tax assessments for shares of a DISC owned by Roth IRAs. In three separate appeals, the First, Second, and Sixth Circuits addressed separate parts of the same transaction with regard to different taxpayers, finding that Congress's intent in establishing both the DISC and Roth IRA regimes was to allow for the reduction of relevant taxes.

In joining the First, Second, and Sixth Circuits, the Ninth Circuit concluded that, "when Congress expressly departs from substance-over-form principles, the Commissioner may not invoke those principles in a way that would directly reverse that congressional judgment." "It is not our role to save the Commissioner from the inescapable logical consequence of what Congress has plainly authorized." As such, the Ninth Circuit reversed.

By: Daniel Wharton, Chicago

NOL Carryback Period Waiver Applies to Certain Specified Liability Losses

On May 21, 2021, the IRS released TAM 202120015, advising that a corporation that has elected to waive its right to carry back net operating losses under Code Section 172(b)(3) may not separately carry back a specified liability loss (other than a product liability loss) subject to an extended carryback period.

Background

Section 172(c) defines a net operating loss ("NOL") as the excess of deductions over gross income in a given taxable year, subject to certain adjustments. Section 172(b)(1)(A), as in effect before the Tax Cuts and Jobs Act of 2017 (the "TCJA"), provides that an NOL arising in a taxable year beginning before January

1, 2018, must generally be carried back to each of the two years before the year of the NOL and then carried forward to each of the 20 years following the year of the NOL. Pre-TCJA section 172(b)(1)(C) provides an extended ten-year carryback period for specified liability losses ("SLLs"), to the extent they do not exceed the taxpayer's NOL for the year. SLLs consist of product liability losses ("PLLs") and deductible amounts in satisfaction of liabilities imposed under certain federal or state laws (e.g., those requiring the reclamation of land, remediation of environmental contamination, or payment under a workers compensation act). This second subgroup is sometimes referred to as "deferred statutory losses," a legacy term predating the Revenue Reconciliation Act of 1990 (the "1990 RRA") and its consolidated treatment of PLLs with that of deferred statutory losses under the umbrella term of SLLs.

Section 172(b)(3), which was unchanged by the TCJA, permits a taxpayer to make an irrevocable election "to relinquish the entire carryback period with respect to a net operating loss for any taxable year." If such an election is made, the NOL may only be carried forward to reduce taxable income in years after the year in which the NOL arose. Separately, pre-TCJA section 172(f)(6) permits a taxpayer to elect to waive the pre-TCJA section 172(b)(1)(C) ten-year special carryback period for SLLs and to apply the standard two-year carryback period under pre-TCJA section 172(b)(1)(A), instead.

Treas. Reg. § 1.172-13(c)(4) (the "PLL Regulation") provides that if in a given taxable year a taxpayer sustains both a PLL and an NOL not attributable to product liability, any election under section 172(b)(3) to relinquish the entire carryback period does not preclude the PLL being carried back ten years. Treas. Reg. § 1.172-13 was proposed in 1983 and finalized in 1986, years before the 1990 RRA consolidated treatment of PLLs with that of deferred statutory losses under the term SLLs. The PLL Regulation has not been updated since it was promulgated and therefore, it refers only to PLLs.

Treas. Reg. § 1.1502-21(b)(3)(i) specifies the procedure by which a consolidated group can make the carryback waiver election under section 172(b)(3) to relinquish the entire carryback period with respect to a consolidated NOLs ("CNOL") for any consolidated return year.

The IRS Advice

The taxpayer in TAM 202120015, the parent of a consolidated group, had made valid elections under section 172(b)(3) to waive the entire carryback period with respect to CNOLs incurred in certain pre-2018 taxable years. The taxpayer later discovered it had SLLs (including deferred statutory losses) for those years and sought to amend its returns for the relevant years to carry back these losses to the prior ten years pursuant to pre-TCJA section 172(b)(1)(C). The taxpayer stated that it had intended to waive only the general two-year carryback period for NOLs and not the extended ten-year carryback period for SLLs. The IRS disallowed the carryback with respect to deferred statutory losses, addressing each of the taxpayer's arguments in turn before providing its own analysis.

The taxpayer's primary argument was that the IRS cannot inconsistently interpret the section 172(b)(3) carryback waiver provision as permitting the extended carryback period for one subgroup of SLLs, i.e., PLLs, but not the other subgroup of SLLs, i.e., deferred statutory losses. The IRS responded that because the PLL Regulation applies on its face only to PLLs, it is not inconsistent to decline to extend the same treatment to other SLLs.

Second, the taxpayer argued that section 172(f)(6), which allows taxpayers to elect to apply the standard two-year carryback period with respect to SLLs as opposed to the ten-year period, suggests that Congress intended each carryback period to be separately waivable. The IRS responded that Congress could have provided for the right to waive each carryback period separately in its entirety if that was its intent, but it did not do so in section 172(b)(3), which in the IRS's view applies to all carryback periods for a given year's NOL.

Third, the taxpayer argued that the PLL Regulation should be extended to all SLLs as a matter of administrative law and statutory construction. In *Clark v. Martinez*, 543 U.S. 371 (2005), the Supreme Court ruled that where a statute applies the same rule to different categories of subjects, an agency must apply its interpretations of the rule consistently to all categories because "[t]o give [the] same words a different meaning for each category would be to invent a statute rather than interpret one." The taxpayer argued that because the extended carryback period and other operative rules of pre-TCJA section 172 made no distinction between PLLs and deferred statutory losses, *Clark* requires the IRS to apply the interpretive rule of the PLL Regulation consistently to all subcategories of SSLs. The IRS rejected this argument with little analysis, concluding that *Clark* does not apply to a "regulatory exception."

Finally, the taxpayer argued that a second Supreme Court case, *United Dominion Industries v. United States*, 532 U.S. 822 (2001), requires the application of the PLL Regulation to deferred statutory losses. In that case, the Court formulated an exception to the canon of statutory interpretation that the mention of some implies the exclusion of others not mentioned. Where a regulation provides that a certain category of items be treated in a particular way, the omission of an item from that list implies that it should not be so treated only "if there was a good reason to consider the treatment of [that category] at the time the regulation was drawn." On the other hand, "if there was no reason to consider [the treatment of that category] then, its omission would mean nothing at all." Accordingly, the Court reasoned, where the statute interpreted by a regulation is subsequently amended to include a new category of items, the omission of that category from the original regulation is meaningless, and the issue is whether that omission was intentional or merely the result of a failure to update the regulation. Applying *United Dominion* to the case at hand, the taxpayer argued that the omission of deferred statutory losses from the PLL Regulation was merely the result of Treasury's failure to update the regulations after the 1990 RRA amended the statute to combine the treatment of PLLs and deferred statutory losses. Accordingly, the taxpayer argued that the logic of the PLL Regulation should apply to the subsequently added category of deferred statutory losses as well as to PLLs. The IRS characterized this argument as supporting application of the legislative reenactement doctrine, which provides that Congress is deemed to approve agency pronouncements interpreting a statute when it reenacts the statute without substantial change. Given that Congress made many substantial, relevant changes following the promulgation of the PLL Regulation, including the addition of the SLL category, the IRS concluded that the legislative reenactment doctrine did not apply in this case.

The IRS concluded the advice with an outline of its own argument that a section 172(b)(3) election waives all carryback periods, absent a regulatory exception. The IRS reasoned that because section 172(c) defines an NOL as the excess of all allowable deductions (including those attributable to SLLs) over gross income, there is only one NOL for a given year, and not a separate NOL for each type of loss which is subject to a special carryback period. Therefore, the general rule is that an election to relinquish "the entire carryback period with respect to a net operating loss" must apply to the single NOL arising in the applicable year, waiving all associated carryback periods. Under this interpretation, the PLL Regulation is a regulatory exception in the case of PLLs, but the general rule still applies to other SLLs. Further, the IRS noted that Treas. Reg. Section 1.1502-21(b)(3)(i), which sets out the procedure for a consolidated group to make the carryback waiver election, does not require the taxpayer to specify which carryback period it is waiving. This is consistent with the interpretation that an election under section 172(b)(3), by its terms, waives all carryback periods.

Discussion

The unspoken tension in TAM 202120015 lies in how the taxpayer and the IRS characterize the PLL Regulation and its relation to the statute. The taxpayer apparently took the position that the statute is ambiguous as to the effect of a section 172(b)(3) election on the extended carryback period for SLLs and that the PLL Regulation is a regulatory interpretation of that statute in the context of PLLs. Now that the statute treats PLLs and deferred statutory losses identically, the taxpayer argued, the PLL Regulation should be applied consistently to other categories of SLLs under the principles of *Clark* and *United Dominion*. In contrast, the IRS views the PLL Regulation as a "regulatory exception" to a general rule which it apparently thinks is discernible from the statute. While some taxpayers and practitioners might question this characterization, and some prior guidance could be seen as somewhat inconsistent, TAM 202120015 accords with the IRS's more recent guidance on the matter.

In PLR 9444020, the IRS relied on the PLL Regulation to rule that a consolidated group which had elected to waive the NOL carryback period under section 172(b)(3) was still entitled to the ten-year carryback period for SLLs. Without explicitly stating its reason for so ruling, the IRS noted that the PLL Regulation was proposed and finalized before the 1990 RRA adopted the term "SLL" for both PLLs and "deferred statutory or tort liability losses" (the predecessor of the deferred statutory losses at issue in the present TAM). Thus, it would appear that the IRS initially relied on some of the same arguments that it rejected when used by the taxpayer in TAM 202120015.

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Nearly two decades later, the IRS reversed course when it again considered the effect of a section 172(b)(3) waiver on SLLs and other losses eligible for extended carryback periods. In CCA 201136024, the IRS first advised that the waiver applies to all carryback periods because there can be only one NOL per year. The IRS's reasoning (based on the definition of "net operating loss") was almost identical to that in TAM 202120015. In addition, the IRS acknowledged that pre-TCJA section 172(f)(5) provides that an SLL is "treated as a separate net operating loss," to be taken into account after "the remaining portion of the net operating loss" for purposes of determining the order in which losses are absorbed in a carryback or carryover year. However, the IRS emphasized that this was an ordering rule only and that the use of the term "remaining portion" is consistent with the view that for all other purposes, an SLL is simply a portion of the year's one NOL.

TAM 202120015 confirms that the IRS still considers the PLL Regulation to apply only to PLLs and not to other SLLs (or presumably to any other past or future classes of losses subject to special carryback periods). Taxpayers that have made a section 172(b)(3) election with respect to a pre-2018 tax year should be aware that the IRS may challenge an attempt to carry back any deferred statutory losses they later discover for such years. The result in TAM 202120015 will likely be less relevant from a planning perspective going forward because the TCJA eliminated the extended ten-year carryback period for SLLs discussed in the TAM. In addition, current section 172, as amended by the TCJA and the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), does not provide for different carryback periods for different types of losses. Section 172(b)(1)(D) permits a five-year carryback period for all NOLs arising in 2018, 2019, and 2020. NOLs arising in taxable years beginning after December 31, 2020, generally cannot be carried back, except that sections 172(b)(1)(B) and (C) provide two-year carryback periods for farming losses and for losses of insurance companies other than life insurance companies. All of these carryback periods should be waived by a section 172(b)(3) election under the logic of TAM 202120015.

Notwithstanding the limited applicability of TAM 202120015 to NOLs arising after 2017, Congress has frequently revised section 172 in the past to create new special carryback periods and to retire them when no longer considered necessary. If NOL carrybacks of varying lengths are reintroduced in the future, taxpayers should be careful to consider whether waiving the general NOL carryback period will have the unintended consequence of waiving any special carryback periods as well.

By: Moe Worsley, San Francisco and Camille Woodbury, New York

Maryland Court of Appeals Rules that Travelocity is not Liable for Maryland Sales and Use Tax Prior to Enactment of Maryland's Accommodations Intermediary Law

On April 30, 2021, the Court of Appeals of Maryland, the state's highest court, issued its decision in *Travelocity.com LP v. Comptroller of Md.*, No. 14, 2021 Md. LEXIS 200 (Apr. 30, 2021). The court reversed the judgment of the circuit court and ruled that Travelocity, as an online travel company, was not liable for Maryland's state sales and use tax prior to the enactment of Maryland's accommodations intermediary law in 2015. This opinion helps clarify the "pre-accommodations intermediary" law tax obligations of online travel companies, and may also be helpful in understanding the impact of marketplace facilitator law enactments more generally.

Background of State Marketplace Facilitator Laws

While state sales and use tax laws vary widely, as a general rule, the "seller" of a taxable good or service, such as a taxable accommodation, must collect sales or use tax from the purchaser and remit the tax to the state. With the increased prominence of online marketplaces, including online travel companies, states have sought to require the platform itself to collect and remit the tax. Some states have attempted to do this by asserting this position in audits and litigation, which is what led to the controversy in *Travelocity*. Additionally, many states have done this legislatively, by enacting "marketplace facilitator" laws, which effectively shift state sales and use tax collection and remittance obligations from the seller of the taxable good or service to the marketplace or platform that facilitates the sale of the taxable good or service, either by expressly imposing a collection and remittance obligation on a marketplace facilitator or by treating marketplace facilitators as "retailers" otherwise required to collect and remit sales or use tax. Many state marketplace facilitator laws apply broadly to platforms facilitating the sale of any type of taxable goods or services, but some marketplace facilitator laws are more targeted, such as Maryland's accommodations intermediary law, enacted in 2015, which applies specifically to certain online travel companies. (We note that Maryland also subsequently adopted a general marketplace facilitator law in 2019 that applies more broadly to platforms that facilitate sales of taxable goods and services.)

Maryland's Pre-2015 Sales and Use Tax Framework

Prior to 2015, Maryland imposed sales and use tax on "a retail sale in the State; and a use, in the State, of tangible personal property or a taxable service." Md. Code Ann., Tax-Gen. § 11-102(a). Pursuant to the Maryland tax code, a "sale" required a "transaction for consideration" where "title or possession of property is transferred or is to be transferred absolutely or conditionally by any means, including by lease, rental, royalty agreement, or grant of a license for use." Md. Code Ann., Tax-Gen. § 11–101(i). Md. Code Ann., Tax-Gen. § 11-101(k) defined tangible personal property as "corporeal personal property of any nature; or a right to occupy a room or lodgings as a transient guest."

Under this tax framework, the burden of collecting the sales and use tax fell on the "vendors," who were required to collect the tax from the buyer and remit it to the Comptroller of Maryland ("Comptroller"). Md. Code Ann., Tax-Gen. §§ 11-401, 11-403. "Vendors" were defined as persons "engaged in the business of" being either a retail vendor or out-of-state vendor, i.e., selling or delivering tangible personal property into Maryland. Md. Code Ann., Tax-Gen. § 11-101 (o)(1); § 11-701 (b)–(d).

The Accommodations Intermediary Law

In 2015, the Maryland General Assembly amended the sales and use tax statute, Md. Code Ann., Tax-Gen. § 11-102. The amendment to the statute expanded the scope of a "vendor" to include an "accommodations intermediary" — "a person, other than an accommodations provider, who facilitates the sale or use of an accommodation and charges a buyer the taxable price for the accommodation[ ]." The amendment, which became effective in January 2016, was passed with the stated purpose of "altering the definition of 'vendor' under the State sales and use tax to include an accommodations intermediary[.]" 2016 Md. Laws Ch. 3 (H.B. 1065 & S.B. 190 (2015)); S.B. 190 (2015) Fiscal and Policy Note at 1.

The *Travelocity* Case: Lower Court Decisions

Between March 1, 2003 and April 30, 2011, Travelocity.com LP ("Travelocity") operated as an online travel company and contracted with third-party hotel, airlines and car rental agencies to provide an independent platform to review and request reservations. Travelocity coordinated with the central reservation system of the hotels and car rental agencies to ascertain availability and subsequently listed the available rooms and vehicles on its website. Customers could access the Travelocity website could compare options and select their desired reservation on the website. Travelocity operated as the intermediary between the third-party company and the customer, handling payments, confirmation information, and cancellations. For its service, Travelocity charged customers a rate higher than the net rate that the hotels and car rental agencies offered to Travelocity. Thereafter, Travelocity paid the hotels and car rental agencies the net rate for the room, plus taxes on the net rate.

The Comptroller audited Travelocity for the period between March 1, 2003, and April 30, 2011, and assessed sales tax, penalties, and interest of approximately $6.5 million on the difference between the tax on the net rate paid by hotels and car rental agencies and the tax that the Comptroller asserted should have been collected on the total charge paid by consumers (i.e., the net rate plus Travelocity's mark-up).

Travelocity challenged the assessment, arguing that it was not a "vendor" of hotel rooms and rental cars under the then existing state statute and was therefore not required to collect or remit sales tax on the total charge. It bolstered its challenge by citing to the 2015 amendment enacting the accommodations intermediary law, asserting that it was not a vendor before the law change which expressly *expanded* the definition of vendor to include "accommodations intermediary."

On December 18, 2017, the Maryland Tax Court issued a final memorandum and order, finding that Travelocity was engaged in the business of a retail vendor because it sold the right to occupy a hotel room or rent a vehicle, both of which constituted tangible personal property. The Tax Court determined that Travelocity was liable for the tax, but not grossly negligent in failing to pay the sales and use tax during the audit period because "there [was] a good faith dispute as to whether the tax applie[d] to Travelocity."

Both parties subsequently petitioned for judicial review of the Tax Court decision in the Circuit Court for Anne Arundel County. On January 30, 2020, the circuit court affirmed the decision of the Tax Court.

The *Travelocity* Decision

On appeal, the Maryland Court of Appeals (the state's highest court) ruled that Travelocity was *not* required to collect and remit the state's sales and use tax on the total charge collected from consumers during the audit period because it was not a vendor as statutorily defined under the Maryland tax code. Rather, Travelocity merely facilitated reservations with third-party agencies for the right to occupy a hotel room or rent a vehicle during the audit period, and did not acquire title or possession as required for a sale.

The court acknowledged that hotel room reservations and vehicle rentals fell within the definition of tangible personal property pursuant to Md. Code Ann., Tax-Gen. § 11-101(k). The dispute, therefore, was whether Travelocity was a "vendor" who "sold" or "delivered" the hotel and car rental reservations during the audit period. Under the plain language of the statute, the court concluded that Travelocity did not acquire "title or possession" to the hotel room or rental car, as required for a "sale" to occur under Md. Code Ann., Tax-Gen. § 11–101(i). Travelocity's contracts showed that they did not result in the transfer of title or possession of hotel rooms or rental cars. The sample agreements provided on audit further clarified that Travelocity did not purchase or acquire inventory in the hotel rooms and rental vehicles, nor accept any risk of loss for the reservations. Therefore, construing the contracts as a whole, Travelocity could not have "sold" the rooms under Maryland law.

Further, as corroborated by the contracts, the purpose of the agreements was for Travelocity to facilitate hotel and car reservations for the benefit of the hotel and car rental agencies and "to broaden the distribution of [the third-party agencies'] travel products and services through Travelocity." The court described the relationship between Travelocity and the third-party agencies as analogous to a "postal carrier who delivered, for a fee, items from a seller to a buyer while at the same time collecting payment from the buyer to return to the seller."

The Court then turned to the relevance of the superseding 2015 legislation. It concluded that the subsequent inclusion of accommodations intermediary to the definition of vendor demonstrated that intermediaries such as Travelocity were *not* within the scope of the original definition of a vendor. The court noted that the legislative history confirmed that the amendment was passed with the stated purpose of "altering the definition of 'vendor' under the State sales and use tax to include an accommodations intermediary[.]" 2016 Md. Laws Ch. 3 (H.B. 1065 & S.B. 190 (2015)); S.B. 190 (2015) Fiscal and Policy Note at 1. If the amended statute were construed to have the same meaning as the original statute, the additional term "accommodations intermediary" would be rendered surplusage — an unfavorable result in statutory interpretation.

In a dissenting opinion, Judge Shirley M. Watts, joined by Chief Judge Mary Ellen Barbera and Judge Robert N, argued that the lower court decisions should have been upheld because, in the dissenting Judges' opinion, Travelocity did act as a vendor and engaged in sales when customers used its website to reserve hotel rooms or car rentals. The dissenting opinion also asserted that "the circumstance that Travelocity did not immediately transfer possession of the hotel room or rental car to the customer does not change the fact that Travelocity immediately accepted consideration from the customer, and immediately transferred to the customer the grant of a license to use a hotel room or rental car." The dissent argued that these actions were sales under the plain language of the statute and caused Travelocity to fall under the definition of a vendor.

Finally, turning to the 2015 amendment, the dissent reframed the purpose of the amendment as clarifying rather than altering the definition of vendor, characterizing the 2015 amendment to the definition as a "prophylactic measure that confirmed, out of an abundance of caution, what was already the intent under existing law." As noted above, however, the majority disagreed with this finding and held that if the 2015 amendment "was merely clarifying that an accommodations intermediary was already included in the statutory definition of a vendor, then the additional term 'accommodations intermediary' would be surplusage—an unfavorable result in statutory interpretation."

Thus, the majority decision in *Travelocity* has strengthened the position that the enactment of a marketplace facilitator law does not retroactively broaden the obligations of facilitators such as Travelocity. The court observed "that Travel industry practices have long informed the developments of the State's tax legislation," and that "Travelocity's business and technological acumen preceded the State's tax legislation, until the General Assembly 'caught up' with the 2015 amendment." While the court's holding is limited to the accommodations intermediary law, this case could have relevance outside the online travel company context and provides support for an argument that marketplace facilitator laws were intended to *alter* the tax collection and remittance obligations of marketplace facilitators and thus should be prospectively applied, and states should not impose tax collection and remittance obligations on platforms for years before a marketplace facilitator law was enacted.

By: Nicole Ford, New York and Varuni Balasubramaniam, Washington, DC

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IRS Temporarily Allows CFCs an Automatic Accounting Method Change to ADS

Tax guidance often springs from a taxpayer's comments on the practical application of new rules. In May, the IRS released guidance to make it easier for a controlled foreign corporation ("CFC") to switch to the alternative depreciation system ("ADS") under Code Section 168(g) for tangible property. The relief provided in Rev. Proc. 2021-26 was first referenced in the June 2019 global intangible low-taxed income ("GILTI") final regulations (T.D. 9866) after taxpayers requested relief in response to the October 2018 proposed regulations (REG-104390-18).

In December of 2017, the Tax Cuts and Jobs Act ("TCJA") introduced GILTI and its determining formula, which is based on certain items of each CFC that the shareholder owns, including tested income, tested loss, and qualified business asset investment ("QBAI"). Determining each of these items required a series of new definitions, operating rules, and examples to be added to the Code and regulations. Reviewing each of these new provisions is not necessary for the purpose of this article. For further information, please see the previous *Tax News and Developments* articles on the final and proposed GILTI regulations.

Rev. Proc. 2021-26 addresses section 951A(d)(3)'s requirement that the adjusted basis in any property for purposes of calculating QBAI must be determined by using ADS. As with many of the TCJA provisions, Treasury and the IRS moved quickly to release implementing regulations. Under proposed GILTI regulations, ADS generally would have applied to determine the basis of property for purposes of QBAI, irrespective of when the property was placed in service or whether the basis of the property was determined using another method for computing depreciation for other purposes of the Code. *See* Prop. Reg. §1.951A-3(e)(1)-(3). While section 168(g)(1)(A) requires U.S. shareholders of CFCs to use ADS to depreciate tangible property predominantly used outside of the United States, CFCs computing their earnings and profits ("E&P") may instead apply a depreciation method used for their financial accounting purposes or a method consistent with U.S. generally accepted accounting principles, provided that the adjustments required to conform to ADS are not material. *See* Reg. §1.952- 2(c)(2), Reg. §1.964-1(a)(2).

Because taxpayers commented on compliance burdens associated with the proposed regulations, the final regulations provide some relief. For example, the final regulations allow for a taxpayer election out of applying ADS for property placed in service before the first taxable year beginning after December 22, 2017. *See* Reg. §1.951A-3(e)(3)(ii)).

Automatic Accounting Method Change: Treasury and the IRS also promised relief in a future revenue procedure that would expand the availability of automatic consent for accounting method changes to ADS for CFCs, not otherwise required to use ADS for purposes of computing their income and E&P, that want to conform their income, E&P, and QBAI computations.

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Generally section 446 requires a taxpayer to get the IRS's consent to change its depreciation method. While CFCs using an impermissible non-ADS method of accounting generally were allowed to use the automatic accounting method change procedures to do just this, those using a permissible method were not. *See* Rev. Proc. 2015-13, Rev. Proc. 2019-43. Rev. Proc. 2021-26 temporarily expands the automatic consent procedures of Rev. Proc. 2019-43 to CFCs using a permissible method non-ADS method.

Take Note: The guidance also allows for limited retroactive relief. Eligible taxpayers may convert a Form 3115 properly filed under the non-automatic procedures of Rev. Proc. 2015-13 for a limited time.

To be eligible for conversion, the Form 3115:

- must have been filed before May 11, 2021; and
- must have been pending with the national office on May 11, 2021.

In addition, the designated shareholder must notify the national office contact person for the Form 3115 of the CFC's intent to make the change in method of accounting under the automatic change procedures before the issuance of a letter ruling granting or denying consent for the non-automatic change. See Rev. Proc. 2021-26 (modifying Rev. Proc. 2019-43, §6.22). The taxpayer then attaches an acknowledgement sent from the national office with a newly submitted Form 3115 by the earlier of:

- the 30th calendar day after the date of the national office's letter acknowledging the request to convert; or
- the date the designated shareholder is required to file the original Form 3115 under section 6.03(1)(a) of Rev. Proc. 2015-13.

***Additional Guidance Under Rev. Proc. 2021-26*: Rev. Proc. 2021-26 also requires a section 481 adjustment for any automatic accounting method change sought under the guidance. Rev. Proc. 2015-13, §7.07 includes the terms and conditions for a section 481 adjustment reflecting the difference between the CFC's income and E&P under the two methods. Because this provision pre-dated section 951A, Rev. Proc. 2021-26 updates this provision to take section 951A into account in the section 481 computation.

Finally, Rev. Proc. 2021-26 continues to deny audit protection to CFCs for a tax year before the requested year of change in which one or more of its U.S. shareholders computes foreign taxes deemed paid under sections 902 and 960 regarding the CFC that exceeds 150 percent of the average amount of foreign taxes deemed paid by the shareholder regarding the CFC in the U.S. shareholder's three prior tax years. Rev. Proc. 2021-26 modifies the rule in Rev. Proc. 2015-13, §8.02, however, to clarify that the 150 percent threshold is determined using the amount of the foreign corporation's foreign taxes deemed paid, regardless of the extent to which a foreign tax credit is allowed.

Relief Available: The temporary automatic consent procedures of Rev. Proc. 2021-26 are effective for a Form 3115 filed on or after May 11, 2021 for a taxable year of a CFC ending before January 1, 2024.

Takeaway: Taxpayers and their representatives have an opportunity to suggest streamlined and cost-effective tax administration procedures and request corrections or clarification regarding outdated guidance during a comment period. Even when the comments are rejected, the Treasury and IRS may provide insight into their views on the issue. Alexandra Minkovich recently noted that “Given the significant number of guidance projects that are in the works at any given time, identifying areas where a lack of guidance is causing current challenges for taxpayers helps Treasury and the IRS focus on items that will have an immediate impact.” Alexandra Minkovich, *Treasury and IRS Ease Taxpayer Burdens By Allowing an Automatic Method Change to Claim 30-Year ADS Depreciation and the Filing of Amended Partnership Returns*, 37 Real Est. J. No. 7 (July 21, 2021).

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