WASHINGTON TAX UPDATE:
CONGRESS, TREASURY, GLOBAL

August 2019 **Susan Rogers**

Congress passed key budget legislation prior to departing Washington for the month-long August recess, and the President signed the bill. They are scheduled to return on September 9th. The Senate and the House approved legislation called the **Bipartisan Budget Act of 2019** that would **suspend the statutory debt limit until mid-2021** and **lift the statutory caps on discretionary spending for the next two years** (the "sequester"). Although the budget deal represents good news, **there is still opportunity for drama when Congress returns in September**. By the start of FY 2020 on October 1st, Congress will need to have approved appropriations legislation that specifies the funds allocated for the various departments and functions of the federal government.

Boris Johnson has assumed the position of **UK Prime Minister** and has declared that the UK will leave the European Union by October 31st, with or without a new deal. There are reports that **PM Johnson may be preparing for a general election** at some point, in order to address the fact that he now leads a minority government. The UK will leave the EU without a deal unless one of three steps is taken: agreement to a deal, a request for a further delay, or a decision to cancel Brexit. Under the agreement with the EU, the UK may reconsider their entire Brexit strategy, but the extension agreement precludes reopening the withdrawal agreement.

In This Issue

Susan Rogers has 30 years of experience in the tax policy field in Washington including five years as Majority Tax Counsel to the US House Ways & Means Committee and several years of experience managing global tax issues for a Fortune 100 multinational.

She is based in Southern Maine with firm offices in Washington, DC, and Boston. Her practice focuses on federal, state, and global tax developments and strategic management of tax risks for those businesses who need to understand the substance, process, and politics of tax issues. She has extensive experience in training personnel on tax advocacy issues through seminars, webinars, and company meetings.

Ms. Rogers publishes two monthly newsletters including "Washington & the World: US & International Tax" covering newsworthy tax issues affecting cross-border business.

For additional information and subscription details, please contact:
Susan Rogers, Partner
admitted to practice in the District of Columbia & Virginia
202.492.3593
srogers@potomaclaw.com
Southern Maine, Washington DC, and Boston

The Budget/Debt Limit Deal

The 2**-year budget bill** that is now law **would lift the sequester caps on annually appropriated spending** by a total of $320 billion over the next two fiscal years (2020 and 2021), split equally between defense and non-defense spending. As compared to 2019 spending, this represents for 2020 an increase of $22 billion for defense accounts and $27 billion for non-defense with additional increases for 2021. The legislation also **suspends the statutory debt limit through July 2021** – the issue that created the urgency for completing this deal prior to the Congressional August recess.

There were objections from both sides of the aisle to the agreement. Conservatives complained about the fact that the bill, which includes more than $2.7 trillion in spending, was for the most part not paid for, and progressives complained about the amount of authorized defense spending. Only $75 billion of the agreement is offset, and that is done by "budget gimmicks" that have been used in the past including the collection of customs user fees. In the end, however, the threat of a government shutdown and a government default helped get the deal finished.

The **budget deal does not include any tax measures**, such as tax extenders, technical corrections, or retirement security legislation. The next opportunity for miscellaneous tax provisions to find a vehicle for passage this year would be the FY 2020 spending bills, which was suggested by SFC Chairman Grassley on July 31st.

The Tax-Writing Committees

House Ways & Means Committee: The Ways & Means Committee has filed suit in federal court against the Treasury Department and the IRS for access to **President Trump's tax returns** asking the court to enforce subpoenas that have been issued. A DC federal judge later added President Trump and several of his business entities to the lawsuit after they asked to intervene in the case. The House voted overwhelmingly in favor of legislation that would **repeal the excise tax on high-cost health insurance plans – the "Cadillac tax."** The bill has been sent to the Senate, but it is unclear if they will take it up for action anytime soon, although there are reports that leadership is open to Floor action. The tax was included in the 2010 Affordable Care Act but is not scheduled to take effect until 2022. Repealing the law would create a $197 million revenue loss over 10 years, but the current legislation does not cover this revenue loss.

Democrats in the House and Senate introduced **joint resolutions of disapproval in an effort to invalidate recently issued final regulations** from the Treasury Department and IRS that stop actions by certain states to allow their residents to minimize the impact of the $10,000 cap on the federal deduction for state and local taxes **(SALT),** which was included in the TCJA. The resolutions are unlikely, to become law, however, because they would require the President's signature, but this issue is likely to be included in political discussion connected to the 2020 elections.

Senate Finance Committee: Fifteen Senate Democrats sent a letter to Treasury Secretary Mnuchin on July 12th urging him not to pursue administrative action to **index capital gains to inflation**. The letter was sent because of press reports that the Administration is considering bypassing Congress and using regulatory action to make this policy change. The letter questions whether the Administration has the legal authority to act unilaterally on the issue.

Extenders: The **House Ways & Means Committee has approved legislation** that would **extend several temporary tax provisions**, but the legislation has not yet made it to the House Floor for a vote. In comments on the Senate Floor, **SFC Chairman Grassley** (R-IA) discussed tax extenders legislation and the **expected submission of recommendations by six task forces he appointed to assess the extenders prior to the August recess**. The Joint Committee on Taxation issued a report on the temporary tax provisions stating that the **revenue cost would be $920 billion over a 10-year period**, including the cost to extend several of the individual tax provisions that were included in the TCJA. He has stated that the fact that the bill that repealed the "Cadillac tax" was approved by the House without a revenue offset suggests that there may be support for the same approach with an extenders package, which he would prefer to move through the Senate with revenue offsets. There is bipartisan support at the SFC for this approach, but Democrats on the Ways & Means Committee have resisted the idea of not paying for the extenders package.

Technical Corrections: **Technical corrections legislation** continues to be a **low priority** for tax-writers in Congress, and it is hard to see how this legislation moves forward this year if Democrats continue to take the position that they do not want to help Republicans correct errors in legislation that passed without Democratic input.

Retirement Legislation: The House-passed version of **retirement legislation – the Setting Every Community Up for Retirement Enhancement Act ("SECURE" Act) – remains blocked in the Senate** due to the objections from Senator Cruz (R-TX) to the removal of the Code section 529 programs for education savings expansion and potential objections from a handful of other Senators. It remains unclear if Senate leadership will be able to resolve these objections in order to move the bill under unanimous consent or whether they will have to go through the more time-consuming process of bringing it to the Senate Floor for debate.

Tax Treaties: The **Senate approved protocols to four tax treaties** that have been waiting for ratification for years including treaties with Japan, Luxembourg, Spain, and Switzerland. The pending treaties with Chile, Poland, and Hungary are still pending in the Senate Foreign Relations Committee as the Treasury Department seeks to clarify how provisions in those agreements interact with the base erosion and anti-abuse (BEAT) provision enacted in the TCJA.

Treasury and the IRS

Tax Cuts & Jobs Act (TCJA) Guidance

Treasury and the IRS have released a significant amount of guidance on the TCJA to date. Treasury had until June 22, 2018 (18 months after the TCJA was enacted) to issue final rules that would operate retroactively back to the enactment date.

Global Intangible Low-Taxed Income (GILTI): The IRS released **proposed regulations that would expand the exception to the global minimum tax**, with respect to global income that has already been taxed by foreign jurisdictions with a proposal to exempt income where 90% of the US tax rate has been paid — i.e. 90% of 21% or 18.9%. Because it was not included in the final regulations issued before June 22nd, this change will not be available for taxpayers retroactively to the date of enactment of the 2017 legislation. Although the IRS provides some relief with this proposed rule, many believe that Congress intended the fundamental top global rate to be 13.25%, above which residual US GILTI taxation would no longer apply, and clearly the 18.9% is significantly above that rate. Also, several states have passed legislation that excludes GILTI income from full taxation on the state level, including New York which excludes 95% of GILTI from the New York State income tax base. Other states that have addressed the issue include Massachusetts, Connecticut, and Pennsylvania with legislation in Florida and Oregon awaiting signature by the governors of those states.

Opportunity Zone regulations: The IRS **updated its FAQs for Opportunity Zones**. In the updated FAQs, the IRS now poses, and answers in the affirmative, the question of whether a taxpayer can still make a valid deferral election based on an investment that was lower than the total Code section 1231 gain but realized within the 180-day period after the last day of the 2018 tax year under proposed regulations.

Other Issues and Guidance

PFIC Regulations: The IRS issue **proposed regulations under Code section 1298 regarding passive foreign investment company (PFIC) ownership** and "the treatment of certain income received or accrued by a foreign corporation and assets held by a foreign corporation for purposes of section 1297." The guidance clarifies the rules for determining if a US taxpayer holding stock in a PFIC is treated as a shareholder and whether a foreign entity is a PFIC.

New Compliance Campaigns: The IRS Large Business and International (LB&I) Division announced the launch of **six new compliance campaigns** covering the following areas: (1) Corporations' Built in Gains Tax; (2) Post Offshore Voluntary Disclosure Program Compliance; (3) Expatriation; (4) High Income Non-filer; (5) US Territories – Erroneous Refundable Credits; and (6) Section 457A Deferred Compensation Attributable to Services Performed before January 1, 2009.

Partnerships/Allocation of Foreign Income Taxes: The IRS issued **final regulations under Code section 704 on the allocation by a partnership of foreign income taxes**. The rules aim to "improve the operation of an existing safe harbor rule that determines whether allocations of creditable foreign tax expenditures are deemed to be in accordance with the partners' interests in the partnership.

Partnerships/Disregarded Entities: The IRS issued **final regulations that clarify the employment tax treatment of partners in a partnership that owns a disregarded entity**. The new rules "explicitly provide that the owner of a disregarded entity who is treated as a sole proprietor for income tax purposes is subject to self-employment taxes," according to the IRS. The regulations do not address the application of Revenue Ruling 69-184 to publicly traded partnerships, but the IRS says it welcomes additional input on the "exception to the principles" of the revenue ruling for publicly traded partnerships. The final regulations also clarify the applicability date.

Code section 965: The IRS posted a page for **General Section 965 Questions and Answers**, providing informal guidance on complying with Code section 965 regarding the taxation of foreign earnings deemed repatriated under the TCJA. The guidance includes a discussion of making successive installment payments, filing transfer agreements as a result of certain acceleration or triggering events, and other matters related to S corporation shareholders making the Code section 965(i) election.

IRS New Large Corporate Compliance Program

The Large Business and International Division (LB&I) recently announced that it will roll out a **new program, the Large Corporate Compliance (LCC) program**, to replace the Coordinated Industry Case (CIC) program which selects the largest and most complex taxpayers. The primary objective of the LCC program will be to "efficiently focus its resources on noncompliance" by using data analytics to identify which large corporate taxpayers to audit, beginning with the 2017 tax year. The elimination of the CIC program was first suggested in 2015, when the **IRS moved toward more "risk-based" audits**. Some of the key features of the LCC program's use of data analytics will be in identifying case-pointing criteria such as gross assets and gross receipts, which allows for a more "objective determination" of which taxpayers properly belong in the category of the largest and most complex corporate taxpayers. LB&I will then use the data analytics to identify which tax returns are vulnerable to the highest compliance risk, regardless of whether the taxpayer has been under audit. For calendar year taxpayers, 2017 returns could include the Code section 965 transition tax. Pending CIC cases will be completed and closed as CIC cases. **Businesses would be well advised to perform an audit risk assessment especially if they have not been under continuous audit.**

International Issues

Digital Services Taxation/OECD—Global Minimum Tax: The OECD continues working on a **plan to tax digital commerce** as part of the BEPS initiative along with a general discussion of global tax rules with the goal of a final report by the end of 2020. **Finance Ministers and central bank governors from the G-7 agreed to endorse the direction of the international consensus project on digital taxation at the OECD**, despite the fact that the US and France are currently at odds over the new French unilateral proposal. The Chair's summary released after the July 17-18 meeting stated, "Considering the need to improve the current international tax framework, without undermining its principles, Finance Ministers agreed that it is urgent to address the tax challenges raised by the digitalization of the economy and the shortcomings of the current transfer pricing system." **Chip Harter, the US Treasury Deputy Assistance Secretary for International Affairs** commented during the same period of time that the **US must balance its interests**, stating "We do want to show that the United States objects in a robust way against such unilateral actions," while also noting "At the same time, we do want to maintain a positive atmosphere for going forward in the OECD to reach a multilateral consensus."

The US vs. France (and the UK): The **French Parliament has approved a new 3% digital service tax on revenue from some digital activities**, such as targeted advertising and running a digital marketplace, by large companies in France. The current version of the tax, which is modeled on a tax proposal that several EU countries had supported at the EU level, would apply to companies with worldwide digital revenue of at least $845 million and at least $25 million in France, retroactive to January 1, 2019. France will repeal the new tax once a "credible agreement" is reached at the OECD for a global tax. Although France has been accused of targeting large US companies, the tax would reportedly affect US, British, Chinese, German and Spanish businesses and one French company.

The **UK also published draft legislation based on the EU proposal that will be part of the next finance bill which would impose a 2% digital services tax** in April 2020 unless a global agreement is reached by then. **Other countries which are moving ahead with country-specific digital services taxes** include Austria, the Czech Republic, Italy, Poland, Portugal, and Spain.

US Activity: US Trade Representative Robert Lighthizer announced that the **US has launched an investigation of the French digital services tax** under Section 301 of the 1974 Trade Act, which gives the President broad powers to investigate and respond to a foreign country's unfair trade practices and take appropriate action, including retaliation. The issue to be reviewed is whether the French law targets US companies while excluding French ones, because it imposes the tax on large companies and the types of services subject to tax are limited. A hearing has been scheduled for August 19th. Possible outcomes of the USTR action could be new tariffs or other trade restrictions on French goods. **Both SFC Chairman Grassley (R-IA) and Ranking Democrat Wyden (D-OR) publicly stated their opposition to the French tax and their support for the USTR investigation.** They also sent a joint letter to Treasury Secretary Mnuchin urging him to "consider all available tools under US law to address such targeted, discriminatory taxation." The letter encouraged the Secretary to "take all steps necessary to convince the French government to abandon its unilateral DST provision," and they specifically detailed punitive measures available under US law, including Code section 891, under which a double rate of US tax can be imposed on citizens and corporations of foreign countries engaging in discriminatory taxation of Americans.