

# WASHINGTON TAX UPDATE: CONGRESS, TREASURY, GLOBAL



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An assessment of the year thus far for Congress is a mixed bag with many important issues yet to be dealt with in 2019. Although the budget deal that Congress reached before the recess began is arguably an accomplishment, there is still opportunity for problems when Congress returns in September because Congress will need to approve appropriations legislation that funds the federal government before October 1<sup>st</sup>. **The Senate's legislative achievements have consisted of noncontroversial bipartisan measures and must-pass bills,** including disaster relief and emergency aid for the border; an annual military policy measure, and the 2-year budget deal. **The list of achievements for the House mostly consists of symbolic victories,** since most of the approved legislation will not move in the Senate. The Congress has failed to deal with the issues of the high cost of prescription drugs, trade, guns, immigration reform, and infrastructure. As the race for the White House heats up, it is uncertain what Congress will be able to accomplish when it returns on September 9<sup>th</sup>.

New **UK Prime Minister Boris Johnson** has declared that the UK will leave the European Union by October 31<sup>st</sup>, with or without a new deal. **PM Johnson received permission from the Queen to suspend Parliament's session for up to 5 weeks starting in mid-September.** In response, the PM suffered defections from his party that leaves him with a minority government unable to call for a general election. His opponents want to request a 3-month extension from the EU to avoid a no-deal exit at the end of October.

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## Congress/The Tax-Writing Committees

**Senate Finance Committee:** SFC Republican Senator Johnny Isakson (R-GA) announced that he will be retiring at the end of 2019 due to health concerns. Prior to leaving for their August recess, **the Senate Environment and Public Works (EPW) Committee advanced a bipartisan five-year \$287 billion surface transportation authorization bill with the action now shifting to the Senate Finance Committee to determine funding options** before the full Senate votes on the bill. The current authorization does not expire until September 30, 2020. The Chairs of the EPW and SFC Committees have met to discuss funding options including raising fuel taxes, although that idea is not popular with Republicans or Democrats. Staff were tasked with developing options during the recess.

**Extenders:** **The Senate Finance Committee issued reports from three of the six task forces that were set up to examine temporary tax provisions in various policy areas**, specifically the areas of energy, cost recovery, and individual, excise and other expiring provisions. In his statement releasing the three reports, Chairman Grassley (R-IA) said that the outstanding reports are expected to be finalized and announced in the near future. He said that once all reports have been released, the next step will be to prepare a legislative package based on the proposals that the task forces received, the areas of consensus among the task force members, and continued bipartisan discussions. He stated that addressing extenders must be a priority for Congress when it returns in September. The cost recovery task force is, however, the only report that included some consensus ideas, while the other two reports largely just summarized the issues and the comments that were filed from outside groups and industries.

The Ways & Means Committee approved a package of extenders in June, but the full House has not yet voted on it. It remains to be seen, however, whether Congress can agree on an extenders package since House Democrats continue to support the position that an extenders package must be paid for by including revenue offsets.

**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 President signed the protocols. Both Switzerland and Spain have received notification of exchange of instruments. The Swiss protocol will go into effect once the exchange of instruments is complete as will the Japan protocol. Spain's protocol will go into effect 90 days after the country receives notification under the agreement.

The 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 and whether the new treaties would override that provision. These are new treaties and not amended agreements, which means they could override provisions of the TCJA. If Treasury adds reservations to these treaties, the other countries will have to approve them again, which could delay Senate approval. The treaties with Hungary and Chile were signed in 2010, and the treaty with Poland was signed in 2013.

**Inversions:** **The 2017 tax law appears to be having an impact on the attractiveness of corporate inversions with some inverted companies reverting to a structure with a US parent**, and other companies questioning whether there are still tax advantages worth having with a non-US address. One consideration is the new global minimum tax on US companies' foreign income.

**Wayfair Decision legislation:** A Multistate Tax Commission representative has suggested that **federal legislation in response to the US Supreme Court Wayfair decision is currently unlikely to advance** because states are generally not imposing onerous compliance burdens on businesses. He stated that states are giving remote sellers adequate time to comply with tax collection requirements and are not pursuing retroactive collection. Also, the current Chairman of the Judiciary Committee, Jerrold Nadler (D-NY), has expressed reservations about infringing on the states' sovereignty to tax remote sellers.

## The Administration

**The White House:** **The White House is reviewing legislation introduced by Senator Scott (R-FL) that would cut taxes by the amount raised from the tariffs imposed on China.** The US has raised \$43 billion in import duties from the tariffs that are already effective and additional tariffs are effective on September 1<sup>st</sup> and December 15<sup>th</sup>. The details of the Scott proposal have not yet been released.

**The White House has also been considering proposals that would index capital gains to inflation and cut payroll taxes**, although more recent comments from the President indicate that he does not plan to pursue either at this time. In mid-August, White House National Economic Council Director Kudlow said that the White House is working with leaders at the Congressional tax-writing committees on a new plan to cut taxes, which he called "Tax Cuts 2.0". The President has claimed that he has the authority to index capital gains to inflation without new legislation, but Democratic leaders and some tax commentators disagree with this position, while Treasury Secretary Mnuchin has reportedly been studying the issue.

**Crypto Currency Letters from the IRS:** **The IRS announced a compliance effort directed at owners of virtual currencies who may owe back taxes on transactions or who failed to report certain transactions.** More than 10,000 letters have been sent to taxpayers with an IRS request that they review their tax filings and when appropriate, amend past returns and pay back taxes, interest and penalties. There are 3 versions of the "educational" letters, which are all designed to help taxpayers understand their tax and filing obligations and how to correct past errors. In 2018, the IRS launched a new compliance campaign directed at virtual currencies.

## 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 issued Notice 2019-46, which announces forthcoming regulations to allow a domestic partnership or S corporation that is a US shareholder of a controlled foreign corporation to apply proposed regulations issued in October of 2018 (providing for a hybrid method) for determining the amount of the GILTI inclusion. This guidance applies to domestic partnerships and S corporations for taxable years ending before June 22, 2019. The IRS has said that proposed regulations will be issued in the near future that provide rules consistent with two examples covered in this Notice. They have requested comments as to the results described in these examples and what general standards or principles should be applied with respect to the application of the Proposed Regulations. The guidance also provides penalty relief for a domestic partnership or S corporation that acted consistently with proposed §1.951A-5 on or before June 21, 2019, but files a tax return consistent with the final regulations under §1.951A-1(e). Certain notification and reporting outlined in the Notice must be met to prevent the penalties.

**Opportunity Zone regulations:** December 31, 2019, will be a critical day with respect to investments in Opportunity Zones since under the current guidance, that is the last day to invest in a Qualified Opportunity Fund to get the potential 15% step-up basis over 7 years, and the first day when investors can put their 1231 gains from 2019 into QOFs. Under the law, investors must reinvest capital gains into QOFs by December 31, 2019, and hold them for seven years to qualify for 15% forgiveness on the taxable gains from the investment. If the funds are held for five years, then 10% of the capital gains are forgiven. Both the seven and five-year windows end on December 31, 2026, which is the date when gains can no longer be invested in QOFs. Gains generally must be invested in a QOF during a 180-day window beginning on the date of the sale or exchange.

Under the second set of proposed regulations that were issued, capital gains from the sale or exchange of Section 1231 property used in a trade or business are eligible for the tax deferral if invested in a QOF. Capital gain income from Section 1231 property is determinable only as of the last day of the taxable year so the 180 day window starts on that day – but also ends on that day for the investment rule for 7 years in a QOF. Some commentators have suggested that the government should consider having the 180-day window start on the date of the sale or exchange of the 1231 property.

**Penalty Waiver:** The IRS has announced that it will automatically waive 2018 tax under withholding penalties and issue tax refunds for those who are eligible for such a waiver but haven't yet claimed it on their tax returns. The waiver applies to those taxpayers who paid at least 80% of their estimated taxes for 2018 through withholding but did not claim relief by filing the required form – Form 2210.

### Other Issues and Guidance

**Cloud Transactions and Digital Content:** The IRS issued proposed regulations on the classification of cloud transactions under US international tax provisions. The rules are also designed to classify “transactions involving computer programs, including by applying the rules to transfers of digital content.” Existing rules under §1.861-18, which date back to 1998, still provide useful guidance for transactions involving digital content, according to the IRS. The new rules would broaden the application to include digital content, “which is defined in proposed §1.861-18(a)(3) as any content in digital format that is either protected by copyright law or is no longer protected solely due to the passage of time (e.g., books, movies, and music in digital format, in addition to computer programs).” The proposed rules are intentionally broad with the IRS explaining that the definition of cloud transactions is intended also to apply to other transactions that share characteristics of on-demand network access to technological resources, including access to streaming digital content and access to information in certain databases.

The IRS also noted that cloud computing transactions, “which are typically characterized by on-demand network access to computing resources, would not generally be subject to classification under existing §1.861-18 since such transactions typically do not include the transfer of a computer program, nor would such transactions be subject to proposed §1.861-18 since such transactions typically do not include the transfer of a copyright right or copyrighted article, or provision of development services related to computer programming. Thus, the proposed rules provide for classifying a cloud transaction as either a provision of services or a lease of property or both. Publication in the Federal Register is scheduled for August 14th, and comments are due 90 day thereafter.

**Bonus Depreciation:** The IRS issued Revenue Procedure 2019-33, which permits taxpayers to make a late election, or to revoke an election, under Code sections 168(k)(5), 168(k)(7), or 168(k)(10). The guidance covers certain property acquired by the taxpayer after September 27, 2017 and placed in service or planted or grafted, as applicable, by the taxpayer during its taxable year that includes September 28, 2017. Under Code section 168(k)(5), a taxpayer can elect to deduct additional first year depreciation for certain plants. The IRS explains that “Section 168(k)(7) allows a taxpayer to elect not to deduct additional first year depreciation for any class of qualified property placed in service by the taxpayer during the taxable year to which the election applies.” Code section 168(k)(10) allows a taxpayer to elect to deduct 50%, instead of 100%, additional first year depreciation for certain qualified property.

## 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. The OECD is scheduled to report on the economic impact of proposals in October of 2019, and there will be another public consultation on this project this fall. Currently, **one of the areas of dispute between the US and France is whether big tech companies should be singled out** or whether the global proposals should address businesses in all industries. The US Treasury and the US business community favor the OECD-led, multilateral approach, which they believe will lead to a global proposal that is fair and applies to all industry sectors. Another key issue with respect to a potential global minimum tax will be the tax rate with interesting comments from the OECD Director of the Centre for Tax Policy and Administration suggesting that the tax rate could be close to the 12.5 % Irish corporate rate.

**The US vs. France (and the UK and EU):** In a joint press conference with President Trump at the close of the G7 summit, French President Macron publicly confirmed that the US and France have reached a compromise agreement which requires France to **refund or credit all digital services tax (DST) paid by multinationals once a new international system for taxing multinationals in the digital industry is in place**. Reactions from the business community including in the EU were not enthusiastic to this plan, however, with many stating that this approach would lead to greater tax uncertainty and heavy administrative burdens on the business sector. Prior to this agreement, President Macron signed into law a new 3% digital services 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 from January 1, 2019.

**The UK released details of a proposed 2% tax on digital revenue** with an effective date of April 1, 2020, as part of its 2019-2020 Finance Bill. As with the French tax, this tax would terminate if global consensus is reached on the taxation of digital services. Reaction from the leaders of the Congressional tax-writing committees included comments that a UK digital services tax could jeopardize a post-Brexit US-UK trade deal. **The new president of the European Commission** has stated that she also wants to address taxation of digital companies in order to make them pay their fair share of taxes, but with the transition of the EU leadership, it may be months before tax policy initiatives could advance, and tax proposals require unanimity, which was the problem with approving the prior EU proposal. Proposals from the other countries that are moving on a unilateral basis have not yet been enacted into law, including Spain, Italy, Austria, and the Czech Republic.

**US Activity/Digital Taxes:** Previously, the **US had launched an investigation** under Section 301 of the 1974 Trade Act into the French tax, and it is possible that the same action will be taken with the proposed UK DST. A hearing was held on August 19th. **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**. With the news about the US-France deal, SFC Ranking Democrat Wyden urged caution saying “The Trump administration should reject any deal that allows France and other countries to move ahead with discriminatory taxes on US technology companies, in exchange for vague promises down the line.” He went on to say that “If Donald Trump gives France a pass now, then it will be open season for foreign governments to go after major American employers.”

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