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TABLE OF CONTENTS

Preface

Jurisdiction chapters

USA

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Overview of corporate tax work over the last year

Throughout 2023, both public and private companies engaged in a broad scope of corporate tax work. At the same time, the Internal Revenue Service (IRS) intensified its efforts to enhance tax compliance and enforcement, particularly in areas involving complex international transactions and high-net-worth individuals. These efforts include leveraging advanced data analytics and expanding audit activities. The IRS also began to improve its taxpayer services, including enhancements to the IRS website, increased support for online filing, and expanded access to taxpayer assistance centres.

Types of corporate tax work

Just as much of the corporate tax work for 2022 focused on the implementation of tax changes passed as part of the Tax Cuts and Jobs Act (TCJA) and the tax regulations thereunder that the Treasury and the IRS issued in 2021 and 2022, this work continued in 2023.

The dominant role of e-commerce during the pandemic resulted in tax planning and tax controversy with transfer pricing, income sourcing and the nature of intercompany transactions dominating workstreams and the court dockets.

Planning to reduce worldwide cash taxes through utilisation of existing tax attributes and deductions remained popular, while large internal restructuring projects began to take shape but remained mostly in the feasibility phase due to uncertainty brought upon by possible tax reform in the United States as well as globally.

Many countries outside the United States adopted the OECD BEPS 2.0 recommendations and U.S.-based multinationals have focused on complying with those rules and the implications for these multinationals. At the same time, companies were engaged in implementing tax-efficient structures and strategies to minimise tax liabilities in addition to navigating new regulations and worldwide changes in tax laws.

Significant deals and themes

In 2023, there were 154 U.S. initial public offerings (IPOs) on the U.S. stock market, representing a 15% decrease from the 181 IPOs in 2022 and an 85% drop from the all-time record of 1,035 IPOs set in 2021.[1]

In 2023, there were 31 SPAC (Special Purpose Acquisition Company) IPOs. This represents a significant decline compared to previous years, particularly the peak in 2021 when there were 613 SPAC IPOs. The decrease in SPAC activity was influenced by factors such as disappointing performances of newly de-SPAC'd companies, increased scrutiny from the Securities and Exchange Commission (SEC), economic uncertainties, and rising interest rates.[2]

SPACs continue to present tax challenges from a U.S. corporate tax perspective. A SPAC set up as a foreign corporation is generally treated as a passive foreign investment company (PFIC) for U.S. federal income tax purposes. Direct and indirect investments in PFICs may result in a higher effective U.S. tax rate for U.S. shareholders as well as onerous compliance requirements for both the SPAC and its investors.

The private equity market remained intensely competitive, with many firms struggling to deploy capital at projected rates and facing competition from strategic corporate buyers, especially in the high-tech and biotech sectors. Many strategic acquisitions were driven by digital transformation and innovation needs. We anticipate this trend to continue.

Credit, distressed debt and asset securitisation activities continued at a brisk pace with many traditional private equity and hedge fund investors deploying their capital in these alternative strategies to generate higher fixed income returns in a low-interest rate environment. Relaxation of certain regulatory restrictions for these transactions made it easier to attract global institutional capital.

U.S. real estate transactions focused on residential real estate, infrastructure and opportunity zone investing. The remote work and business environment accelerated migration to low- or no-income tax states, causing real estate acquisition sprees in Florida, Texas, Colorado and other similarly situated states.

Despite fast-paced innovation in the blockchain and crypto space, the U.S. market continues to face uncertainty given the lack of tax guidance from the SEC on the nature of crypto assets (i.e., security *v.* commodity *v.* other property). In August 2023, the IRS issued proposed regulations (REG-122793-19) for broker reporting requirements related to digital asset sales and exchanges. These regulations aim to improve transparency and compliance in the rapidly evolving digital asset market.

It is clear at this point that the U.S. government will not recognise crypto as currency, but it will be helpful if the SEC could conclude as to whether it should be treated as a "security", "commodity" or "other property" for regulatory purposes. The U.S. courts currently treat crypto assets as a commodity whereas the tax law generally treats such assets as property. Despite these uncertainties and extreme volatility, crypto assets remain popular with investors and we anticipate further growth and innovation to drive the crypto industry.

Key developments affecting corporate tax law and practice

The past 12 months have resulted in many developments for the U.S. tax practice, including legislative actions, corporate tax changes, and IRS initiatives. These developments reflect a dynamic and evolving tax landscape, with significant implications for taxpayers and tax professionals alike. Moreover, the significant cases and developments in 2023 highlight the ongoing complexities and evolving nature of state and local taxation.

Our summary below focuses primarily on legislative changes, case law and policy developments affecting multinational corporate groups and foreign investors in the U.S. markets.

Legislative developments

On November 30, 2023, the U.S. House Ways and Means Committee unanimously passed the bipartisan United States-Taiwan Expedited Double-Tax Relief Act (H.R. 5988).[3] This legislation aims to provide certain tax benefits for income derived from U.S. sources by eligible Taiwanese residents. The bill introduces Section 894A to the tax code and includes a new clause that empowers the President to negotiate and establish non-self-executing tax agreements with Taiwan. These agreements will ensure bilateral tax relief once it is confirmed that Taiwan extends equivalent benefits to U.S. individuals, as stipulated in Section 894A. This new provision is akin to an earlier proposal by the Senate Foreign Relations Committee, which also advocated for a tax agreement with Taiwan.

Congress has turned its attention to the taxation of crypto assets, initiating public consultations to gather input on regulatory frameworks. Specifically, on July 12, 2023, Senators Cynthia Lummis (R-WY) and Kirsten Gillibrand reintroduced the Lummis-Gillibrand Responsible Financial Innovation Act.[4] This move aims to address the complexities and uncertainties surrounding the taxation of digital currencies, ensuring comprehensive and clear guidelines for taxpayers.

On March 9, 2023, President Biden released the Administration's budget plan for fiscal year 2024,[5] along with the Treasury Greenbook,[6] aiming for a $3 trillion reduction in the deficit by increasing taxes on corporations and wealthy individuals.

This budget serves as a blueprint for the President's policy preferences, regardless of their likelihood of enactment. It contrasts with the spending cuts proposed by House Republicans and includes tax provisions that were not included in the final Build Back Better negotiations, which ultimately resulted in last year's Inflation Reduction Act (IRA), Public Law 117-169. The proposals feature a quadrupling of the IRA's stock buyback excise tax from 1% to 4% and a "billionaire's tax" that would impose a 25% minimum tax on total income, including unrealised capital gains, for those with wealth exceeding $100 million. Many of these tax proposals are drawn from the President's previous budgets and the House-passed Build Back Better Act (H.R. 5376) that did not pass the Senate.

The FY 2024 Budget also proposes raising the corporate tax rate for C corporations from 21% to 28%. Other corporate tax changes aim to prevent corporations from avoiding dividend treatment for shareholders through certain property transfers, limit tax avoidance via leveraging in divisive reorganisations, restrict losses in liquidation transactions, and prevent basis shifting among related parties through partnerships.

The international tax proposals in the FY 2024 Budget largely revisit ideas from previous budgets, aiming to generate over $1.1 trillion, or 29%, of the total net tax increases. Key proposals include:

- Reducing the Section 250 of the Internal Revenue Code (Code) deduction to 25%, which, with the proposed corporate rate hike, would raise the effective rate on global intangible low-taxed income (GILTI) described in Code Section 951A to 21%.
- Aligning the GILTI regime with the global minimum tax rules under OECD BEPS Pillar Two, by applying GILTI rules on a country-by-country basis.
- Replacing the base erosion and anti-abuse tax (BEAT) with an "undertaxed profits rule" (UTPR) consistent with Pillar Two rules.
- Repealing the deduction for foreign-derived intangible income (FDII).
- Creating a new business credit equal to 10% of eligible expenses for onshoring a trade or business to the United States.

- Disallowing deductions for expenses related to moving a U.S. trade or business offshore.
- Removing exceptions in computing a controlled foreign corporation's earnings and profits for Code Section 952(c) purposes.
- Limiting foreign tax credits (FTC) on sales of hybrid entities.
- Restricting deductions for excessive interest expenses.

These tax proposals are intended to increase revenues to support the Biden Administration's priorities. If enacted, they would significantly raise taxes on U.S. multinational companies. Taxpayers should monitor these proposals closely, as their repeated inclusion in past legislation and budgets suggests they might reappear as revenue offsets in future legislation.

U.S. tax considerations related to the OECD BEPS 2.0 Initiative

On December 11, 2023, the Treasury and the IRS released Notice 2023-80, providing guidance on how FTC rules and dual consolidated loss (DCL) rules interact with top-up taxes imposed under the Pillar Two Global Anti-Base Erosion Model Rules (GloBE Rules). This includes the Income Inclusion Rule (IIR) and a Qualified Domestic Minimum Top-Up Tax (QDMTT). The government also announced plans to propose regulations that will align with this new guidance. This guidance aims to align U.S. tax practices with international standards and reduce the risk of double taxation for U.S. multinationals.

Congressional Republicans have voiced strong opposition to the OECD's UTPR.[7] They argue that the rule could disadvantage U.S. companies and have urged other countries to delay its implementation. Instead, they advocate for an approach similar to the existing regime, which aims to mitigate base erosion and profit shifting without overly penalising U.S. firms.

U.S.-Chile income tax treaty[8]

In December 2023, the United States and Chile exchanged instruments of ratification for their first income tax treaty. The treaty came into force on December 19, 2023, after the United States notified Chile that all necessary procedures had been completed. For taxes withheld at source, the treaty will apply to amounts paid or credited on or after February 1, 2024. For all other taxes, the treaty will apply to tax periods beginning on or after January 1, 2024.

Selected tax cases affecting U.S. and foreign multinationals

On December 5, 2023, the U.S. Supreme Court heard oral arguments in the tax case *Moore v. United States*, Docket No. 22-800.[9] The taxpayer argued that the transition tax under Code Section 965 is unconstitutional, claiming it violates the Apportionment Clause and the Due Process Clause of the Fifth Amendment because it imposes a direct tax on unrealised income. The Supreme Court had previously agreed to hear the case in June 2023 when it granted the petition for *certiorari*.

The TCJA introduced the deemed repatriation tax to transition from a worldwide to a territorial tax system. This tax applied to accumulated foreign earnings that had not been previously taxed by the United States. If the Supreme Court rules in favour of the Moores, it could have significant ramifications for various tax provisions that rely on similar principles, such as the GILTI and Subpart F rules.

In November 2023, the U.S. Tax Court issued a ruling *in YA Global Investments, LP v. Commissioner* (161 T.C. No. 11), determining that a foreign partnership was engaged in a U.S. trade or business due to the activities of its U.S.-based asset manager. Consequently, the partnership was liable for withholding tax under Code Section 1446 on the portion of its taxable income that was effectively connected with that trade or business and allocable to foreign partners.

The court found that the partnership's asset manager, Yorkville Advisors, acted as an agent for YA Global, thereby establishing a U.S. office for the partnership. This engagement went beyond the safe harbour for trading in stocks or securities under Code Section 864(b)(2)(A), as the partnership earned fees that constituted compensation for services, not merely returns on investment capital.

Additionally, the court noted that the limitations period for tax assessment did not begin because YA Global filed Form 1065 but failed to file Form 8804, which is required for withholding tax under Section 1446.

In *Culp v. Commissioner*, No. 21-2 (3d Cir. 2023), the United States Court of Appeals for the Third Circuit decided a case involving a challenge by the Culps, who were issued a tax deficiency by the IRS. The taxpayers missed the statutory 90-day deadline to file a petition with the Tax Court to contest the deficiency. The primary issue was whether the statutory deadline in Code Section 6213(a) is jurisdictional, meaning it must be strictly followed without exceptions, or whether it is subject to equitable tolling, which allows for extensions under extraordinary circumstances.

The court ruled that the 90-day deadline is not jurisdictional, which means it can be subject to equitable tolling. This decision reversed the prior Tax Court ruling that had dismissed the case for being untimely. This ruling is significant as it allows taxpayers who miss filing deadlines due to extraordinary circumstances to still have their day in court. It opens the possibility for taxpayers to argue that their missed deadlines should be excused based on equitable tolling.

In *Polselli v. IRS*, 143 S. Ct. 1231 (2023), the Supreme Court ruled unanimously that the IRS does not need to provide notice to third parties when issuing summonses for the purpose of collecting an existing tax liability.

Remo Polselli underpaid his federal taxes over several years, accruing more than $2 million in unpaid taxes and penalties. To collect these unpaid taxes, IRS Revenue Officer Michael Bryant issued summonses to various banks seeking financial records of Polselli's wife and his legal representatives. The IRS did not notify Polselli's wife or the law firms about the summonses. The core issue was whether the IRS is required to notify individuals when issuing third-party summonses to collect delinquent taxes.

In ruling for the IRS, the court held that the exception to the notice requirement under Code Section 7609(c)(2)(D)(i) applies when the summons is issued to aid in the collection of assessed tax liabilities. This decision aligns with the interpretation that if the IRS is in the collection phase, rather than the determination phase of a taxpayer's liability, notice is not required. This ruling reinforces the IRS's broad authority to issue summonses without notifying third parties if the purpose is to collect assessed taxes.

Transfer pricing

In the fall, the IRS appealed the decision of the U.S. Tax Court in the case of *Medtronic, Inc. and Consolidated Subsidiaries v. Commissioner*, T.C. Memo 2022-84 (2022) (referred to as *Medtronic III*), to the Court of Appeals for the Eighth Circuit (case numbers 23-3063 and 23-3281). The Tax Court's decision, dated August 18, 2022, applied an unspecified method to determine the royalty rate for a licence agreement between Medtronic, Inc. (Medtronic US) and its Puerto Rican subsidiary.

The Notice of Appeal does not clarify the basis for the IRS's appeal. In its latest decision, the Tax Court determined income tax deficiencies totalling around $175 million, plus interest, for the tax years 2005 and 2006.

The Tax Court's opinion in *Medtronic III* offers guidance on related-party transactions by rejecting the Comparable Uncontrolled Transaction (CUT) and Comparable Profits Method (CPM) as the preferred methods and instead employing an unspecified approach. The outcome of the IRS's appeal to the Eighth Circuit will establish significant precedent for future cases.

In *Eaton Corporation and Subsidiaries v. Commissioner of Internal Revenue*, Docket No. 5576-12, Eaton faced issues with its transfer pricing methodology for Advance Pricing Agreement (APA) annual reports in 2005 and 2006. Errors in these reports led the IRS to cancel Eaton's APAs and propose a $75 million adjustment with $51 million in Code Section 6662 penalties.

The Tax Court ruled that the IRS was not authorised to cancel Eaton's APAs and rejected the assertion of penalties. The IRS appealed, but the Sixth Circuit upheld the Tax Court's decision, stating that the IRS failed to prove it had grounds to cancel the APAs under contract law principles. In February 2023, a final decision was issued, resulting in an $8.8 million adjustment for the tax years in question, with no penalties.[10]

U.S. state tax developments

In 2023, there were several notable cases in the realm of state and local taxation that significantly impacted taxpayers and tax policies across the United States. Below are details on some of the most influential cases and their implications:

In two different cases, the court decisions illustrate the ongoing debate and split among states on whether to adopt a performance-based or market-based rule for sourcing service receipts.

The Pennsylvania Supreme Court decided in *Synthes USA HQ Inc. v. Commonwealth*, 289 A.3d 846 (Pa. 2023), that the costs of performance rule should source sales to where the service is fulfilled and the income is finally produced, essentially at the customer's location. This ruling deviates from the performance-based rule typically applied by most other states.

In contrast, in *Billmatrix Corp. v. Florida Department of Revenue*, No. 2020-CA-000435 (Fla. 2d Cir. Ct. Mar. 1, 2023), the court decided that Florida's costs of performance rule requires sales to be sourced based on where the taxpayer performs its activities, not where the customers are located. The decision was grounded on the plain language of Florida's rule, which emphasises the taxpayer's activities rather than customer actions or locations.

In *Comptroller of the Treasury of Maryland v. Comcast*, 297 A.3d 1211 (Md. 2023), the Maryland Supreme Court invalidated a trial court's decision that deemed the nation's first digital advertising tax unconstitutional, requiring administrative review before judicial determination. Comcast and Verizon challenged the tax's constitutionality, citing the Internet Tax Freedom Act (ITFA), the Commerce Clause, and the First Amendment. Comcast and Verizon sought a declaratory judgment to invalidate the tax. In March 2022, the trial court allowed the case and ruled the tax unconstitutional in October 2022. As noted above, in May 2023, the Maryland Supreme Court dismissed the case on jurisdictional grounds, stating that the challenge should go through administrative review. Thus, at present, the constitutionality of the tax remains unresolved. Multiple cases are pending in Maryland.

New regulations and guidance issued by the U.S. tax authorities

The IRS has released interim guidance in Notice 2024-16 regarding the treatment of basis adjustments under Code Section 961(c) in the context of inbound liquidations or asset reorganisations. This guidance helps clarify the tax implications for corporations undergoing significant structural changes.

The IRS has proposed amendments to regulations under Code Section 367(b), which affect certain cross-border reorganisations and inbound non-recognition transactions (REG-117614-14). These changes aim to streamline tax treatment and provide clarity on the application of these rules in international transactions.

The Treasury and the IRS released proposed regulations (REG-124064-19) on May 2, 2023, introducing new rules for the "repatriations" of intangible property (IP) under Section 367(d). These regulations would, under certain conditions, allow the annual inclusions mandated by Section 367(d) to cease. The proposed regulations will only apply to IP repatriations that occur on or after the publication date of the final regulations.

Further interim guidance on corporate alternative minimum tax promulgated in the IRA has been released in Notice 2023-64, including a waiver for penalties related to the failure to make estimated tax payments. This guidance aims to facilitate compliance and provide relief for corporations adapting to the new tax regime.

On January 4, 2022, the Treasury and the IRS issued final regulations (TD 9599) containing the attribution rules and the creditability of foreign taxes under Code Sections 901 and 903. On July 21, 2023, the IRS issued Notice 2023-95, temporarily exempting taxpayers from the regulations under Sections 901 and 903 that identify foreign taxes eligible for a credit. This comprehensive notice permits taxpayers to claim an FTC for many foreign taxes that previously might not have qualified under the new FTC regulations.

The Employee Retention Credit (ERC) was designed to help companies retain employees during the COVID-19 pandemic by providing financial incentives. However, the IRS noted a significant rise in potentially fraudulent claims, leading to a temporary halt in processing these claims to conduct a thorough investigation. This surge in claims was partly due to companies, termed "ERC mills", which advertised their services to file ERC claims on behalf of businesses, often promising easy payments with minimal risk of audit.

By September, the IRS had received around 3.6 million claims, with over 600,000 of those pending processing, most of which had arrived in the last 90 days. The IRS's Criminal Investigation Division had already initiated 252 investigations related to ERC fraud, involving over $2.8 billion in claims, resulting in federal charges and convictions with average sentences of 21 months.

To address this issue, the IRS introduced two programmes.[11] First, businesses that have not yet had their claims processed could withdraw their claims without penalty. Second, a voluntary disclosure programme was established for businesses that had received funds but were now deemed ineligible. This programme, running through March 22, 2024, allows these businesses to repay 80% of the received funds. Participants in this programme must also disclose any advisors who assisted with their claims, aiding the IRS in identifying and addressing the practises of ERC mills.

Eligibility for the voluntary disclosure programme requires that the employer is not under criminal investigation, is not subject to an IRS employment tax examination for the relevant period, has not received a repayment notice from the IRS, and is not known to be non-compliant based on third-party information or IRS enforcement actions. Applications must be submitted electronically using Form 15434, and employers may apply through their payroll administrators if applicable.

On September 8, 2023, the Treasury and the IRS issued Notice 2023-63, outlining rules under consideration for future regulations related to Code Section 174, as amended by the TCJA. This notice also addresses the treatment of SRE (Specified Research or Experimental) expenditures under Code Section 460 and the application of Section 482 to cost-sharing arrangements involving SRE expenditures.

The proposed regulations would take effect for tax years ending after September 8, 2023. Code Section 174(a)(2) mandates that taxpayers must capitalise SRE expenditures and amortise them over five years (or 15 years for foreign research expenditures under Section 41(d)(4)(F)), starting from the midpoint of the tax year in which the expenditures were paid or incurred. These amended rules apply to SRE expenditures for tax years beginning after December 31, 2021.

Developments affecting attractiveness of the U.S. for holding companies

The 2017 reduction in the U.S. federal corporate income tax rate from 35% to 21% has raised interest in using U.S. companies as holding companies for the Americas-based operations and investments held by foreign companies. Given the current Administration's desire to raise the corporate tax rate and substantially overhaul the recently enacted cross-border tax rules, it is unlikely that we will see further increases in U.S. holding company structures soon. With the possible ascent of the global minimum corporate tax rate and the further tightening of the U.S. anti-corporate inversion provisions, it is possible that more U.S.-based businesses would opt to onshore their holding companies to benefit from the U.S. government's advocacy on their behalf should income allocation or regulatory disputes arise in other jurisdictions.

The year ahead

In the year ahead, we do not expect many changes to the current U.S. tax rules. We do anticipate further increase in tax controversies as governments around the world, including the United States, seek to raise revenues to offset pandemic-related spending. We anticipate an increased focus on revenue allocation across jurisdictions, foreign and domestic, and continued controversy around the finer points of the TCJA. The taxpayers will be well served to review whether their internal documentation is supportive of the tax positions they have taken or plan to take in the future. Attention to detail has never been as important as it is now.

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Endnotes

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