Washington TAX INSIGHT

June 2020

A publication from Prepared in conjunction with Susan Rogers of Potomac Law Group PLLC

Politics and Congressional Activity

*Due to the COVID-19 pandemic, **Congress has spent very little time in session for the last several weeks** with the House convening for a handful of days in May with new rule changes allowing proxy voting, and the Senate in session for several days but not for its full original schedule. Although the House passed additional legislation to address the economic impacts of the pandemic, the Senate has focused primarily on consideration of judicial nominees.*

*The result is that **a number of issues have not been addressed by Congress** including spending bills for the next fiscal year, a defense policy bill, a reauthorization of the Foreign Intelligence Surveillance Act, the federal highway bill, flood insurance, and water infrastructure. House Democrats are now discussing legislation that would combine a five-year renewal of highway funding with tax-favorable victory savings bonds in an economic recovery package, which could be included in the next round of pandemic relief legislation. House appropriations subcommittees have continued their work in preparation for markups, which are planned for early summer. Senate appropriations committees are planning for markups in late June.*

House Rules Change

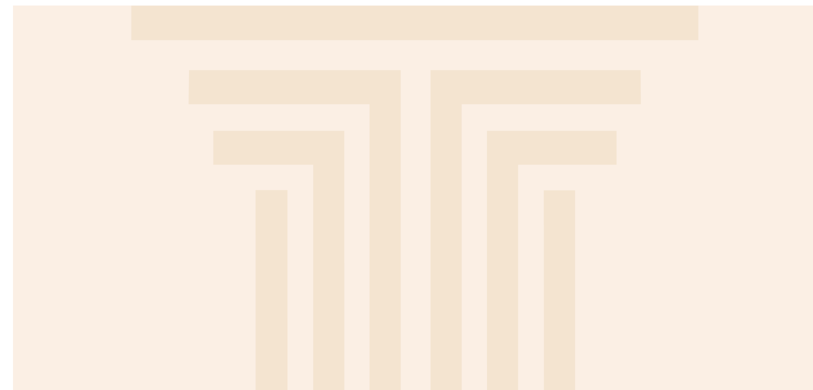
Due to the challenges facing House leadership as a result of the COVID-19 pandemic, the **House has passed a significant change to its rules** that will temporarily allow proxy voting on the House Floor, enabling the House to conduct business and act on legislation with as few as 40 members present who may be voting on behalf of their colleagues. The resolution authorizes the Speaker of the House, in consultation with the minority leader, to implement remote committee proceedings and remote voting in the House during the coronavirus public health emergency. The authority is effective for 45 days with renewal options. **House committees may hold virtual hearings, depositions, and mark-ups** with the option to hold hearings either completely remotely or with some members present in the Capitol and others attending virtually. Current Minority Leader McCarthy (R-CA) opposed the rule change, and he has filed a lawsuit with other Republican members of the House challenging the new proxy rules based on the argument that under the Constitution, a majority of lawmakers must be present to take up business and vote on legislation.

Government Response to COVID-19, the Coronavirus Pandemic

In response to the COVID-19 pandemic, government officials in Washington DC have taken a number of actions related to the economic effects of the crisis including legislation, regulatory action, and government agency action.

As summarized in past True Alerts (Tax Issues Addressed by COVID-19 Emergency Legislation; Congressional Action on the COVID-19 Pandemic: The CARES Act), Congress has passed four major pieces of legislation to provide economic relief to the US economy and US taxpayers. Congress and the White House continue to make recommendations on additional legislation to address the economic impact of the pandemic, although at present the parties are primarily focused on their individual priorities rather than engaging in serious negotiations.

> **"The Senate is not expected to consider the HEROES Act as approved by the House, but rather the bill will function as a starting point for negotiations between Democrats and Republicans in both the Senate and the White House."**



A publication from TruePartners CONSULTING

Prepared in conjunction with Susan Rogers of Potomac Law Group PLLC

The "HEROES Act" – Additional COVID-19 Relief Legislation

On May 15, the **House approved by a vote of 208-199 the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, which is a broad economic recovery package** that proposes significant changes to tax provisions included in the previous COVID-19 relief legislation. It authorizes $3 trillion in federal spending and includes tax provisions directed at states, individuals, health care providers, and businesses.

The **Senate is not expected to consider the HEROES Act as approved by the House**, but rather the bill will function as a starting point for negotiations between Democrats and Republicans in both the Senate and the White House. Senate leadership and other Republican leaders have argued for a pause in pandemic-related legislation in order to evaluate the legislation already enacted and determine the impact on the federal budget deficit.

The **key business provisions** included in the HEROES Act are:

- Amends the taxpayer-favorable changes to net operating loss (NOL) rules enacted in the CARES Act by limiting taxpayers' ability to carry back NOLs generated in 2019 and 2020 to tax-year 2018 instead of the current 5-year carryback period
- Restoring the limitation on excess business losses of noncorporate taxpayers that were suspended by the CARES Act
- Increasing the maximum employee retention tax credit per employee from $5,000 to $36,000
- Allowing taxpayers to deduct expenses paid using proceeds from Paycheck Protection Program (PPP) loans, which would overrule the current position stated in **IRS Notice 2020-32** that these expenses are non-deductible
- Extending the availability of family and medical leave credits through 2021 and increasing the maximum daily limits
- A new 30 percent refundable payroll tax credit for certain expenses paid or reimbursed for employees related to COVID-19 issues
- A new 50 percent refundable payroll tax credit for qualified fixed costs of smaller employers
- A 90 percent refundable income tax credit for certain self-employed individuals who have experienced a significant loss of income
- Changes to rules for multiemployer pension plans, tax-favored retirement accounts, and certain employee benefits plans

The **key individual provisions** included in the bill are:

- A new and expanded round of recovery payments for families
- Suspension of the current-law limitation on state and local tax deductions for 2020 and 2021
- An enhanced earned income tax credit for 2020
- Full refundability of the child tax credit for 2020
- Increases in the child and dependent care tax credit and refundability for 2020
- Above-the-line deductions for teachers and others on the front-line of the COVID-19 pandemic

Other issues covered by the bill include:

- $1 trillion in direct aid to states, municipalities, tribal governments, and US territories
- Assistance to renters and homeowners
- Funds for coronavirus testing
- Assistance to the US Postal Service
- Extension of certain unemployment insurance enhancements enacted in earlier legislation
- Funding for expanded availability of early voting and voting by mail in federal elections

Miscellaneous Issues

CBO Budget Deficit Projections: Preliminary projections released by the nonpartisan Congressional Budget Office (CBO) show that the **budget deficit will reach $3.7 trillion in fiscal year 2020**, which ends on September 30, 2020, and will reach $2.1 trillion in fiscal year 2021. This figure is more than three times what the CBO projected in March of this year. "To develop a preliminary view of the deficit . . . CBO took into account the estimated effects on the deficit of pandemic-related legislation enacted on March 4, March 18, March 27, and April 24," CBO Director Swagel wrote. The largest contributor to the increase is the CARES Act, which will add nearly $1.7 trillion to the deficit in fiscal year 2020.

Joint Committee on Taxation: The Joint Committee on Taxation (JCT) released a report that provides a broad overview of the federal tax system in effect for 2020 reflecting changes to the tax code enacted in the first two COVID-19 relief bills including the CARES Act.

Supreme Court Hearing - Trump Tax Returns: The Supreme Court heard oral arguments regarding Congressional subpoenas seeking President Trump's financial information including his tax returns. Most of the questions focused on defining the limits of Congressional committees' authority to seek the records.

Treasury and the IRS

Tax Cuts & Jobs Act (TCJA) Guidance

Rules on Deducting Fines and Penalties: The IRS issued **proposed regulations on the deduction for certain fines and penalties under §162(f) and related reporting under §6050X** reflecting changes made by the Tax Cuts and Jobs Act (TCJA). The proposed regulations define restitution, remediation, and amounts paid to comply with the law and clarify which amounts are deductible under the statute. The guidance also clarifies (1) how the taxpayer meets the establishment requirement; and (2) how the order or agreement meets the identification requirement. The 6050X part of the regulations also define and instruct on the terms and rules for reporting, and they increase the reporting threshold from $600 to $50,000, thereby eliminating reporting requirements for an "estimated 1 to 5 million orders or agreements." The IRS has invited comments on a number of issues.

A publication from TruePartners CONSULTING

Prepared in conjunction with Susan Rogers of Potomac Law Group PLLC

LB&I Audit Focus – TCJA and CARES Act: The IRS Large Business & International (LB&I) Division announced a **new compliance campaign focused on the TCJA and the CARES Act.** Compliance campaigns are part of the agency's efforts to execute issue-based examinations where compliance issues that present risk require a response in the form of one or multiple treatment streams to achieve compliance objectives. The IRS noted that in 2020, the majority of returns that will be under review by the LB&I will be returns reflecting changes brought about by the TCJA and in light of that, LB&I has initiated the TCJA Campaign to closely monitor issues on a select pool of returns and share information learned throughout LB&I and the IRS. The IRS stated that an additional goal of the campaign is to identify transactions, restructuring and technical issues and better understand taxpayer behavior under the CARES Act.

Treasury/IRS Hearing: On May 20th, Treasury and the IRS held a public hearing via teleconference on proposed regulations that provide guidance relating to the allocation and apportionment of deductions and creditable foreign taxes, the definition of financial services income, foreign tax redeterminations, availability of foreign tax credits under the transition tax, and the application of the foreign tax credit limitation to consolidated groups.

COVID-19 Crisis Guidance & Related Issues

Paycheck Protection Program (PPP) Loans: Treasury announced that companies that mistakenly received a PPP loan will have an additional week to repay the loan without penalty and extended the deadline from May 7th to May 14, 2020. Treasury also announced that companies that repay loans mistakenly received under the PPP are still eligible to access the Employee Retention Credit (ERC). Employers who access PPP loans are not eligible for the ERC but will be allowed to use the credit if they repay the PPP loan by the extended safe harbor deadline of May 14th. Treasury and the Small Business Administration (SBA) updated their FAQ page to explain how the SBA will review borrowers' required good-faith certification concerning the necessity of their loan request.

The IRS issued **Notice 2020-32, which provides guidance regarding the deductibility of certain otherwise deductible expenses incurred in a taxpayer's trade or business when the taxpayer receives a loan (covered loan) pursuant to the Paycheck Protection Program.** The Notice provides that no deduction is allowed for US federal income tax purposes if the payment of the expense results in forgiveness of a covered loan under the CARES Act. The **Chairs of the SFC and the Ways & Means Committee have urged Treasury Secretary Mnuchin to rethink this position,** which they stated was contrary to Congressional intent. SFC Chair Grassley and Ranking Democrat Wyden have introduced bi-partisan legislation to permit businesses that have received PPP loans to deduct covered expenses even if their loans are forgiven. Public comments by Secretary Mnuchin indicate that he may be reluctant to change the position of the Notice, but the IRS Chief Counsel said the issue is being reviewed.

“The IRS noted that in 2020, the majority of returns that will be under review by the LB&I will be returns reflecting changes brought about by the TCJA.”

“The IRS issued Notice 2020-32, which provides guidance regarding the deductibility of certain otherwise deductible expenses incurred in a taxpayer's trade or business when the taxpayer receives a loan (covered loan) pursuant to the Paycheck Protection Program.”

Foreign Business Activity due to Travel Restrictions: The IRS issued **Revenue Procedure 2020-30, directing that certain foreign business activity attributable to travel disruptions caused by the COVID-19 pandemic will be disregarded** for purposes of determining if a company is operating a Foreign Disregarded Entity or Foreign Branch. The IRS explains that the guidance "provides that certain activities are not taken into account for purposes of section 1503(d) or Form 8858, as a result of travel restrictions and disruptions resulting from the global outbreak of the virus that causes COVID-19, individuals may temporarily conduct activities in a foreign country that would not otherwise have been conducted there."

Employee Retention Credit: In a letter to SFC Chair Grassley, **Treasury said it intends to revise its initial guidance on determining allocable qualified health plan expenses for purposes of the Employee Retention Credit (ERC),** which provides a refundable tax credit to eligible employers for certain employment taxes equal to 50 percent of up to $10,000 in qualified wages paid to employees, effective March 12, 2020 through December 31, 2020. In a FAQ, the IRS advised that qualified health plan expenses "are amounts paid or incurred by the Eligible Employer to provide and maintain a group health plan (as defined in section 5000(b)(1) of the Internal Revenue Code (the "Code")), but only to the extent that those amounts are excluded from the gross income of employees by reason of section 106(a) of the Code." In a letter to Treasury Secretary Mnuchin, Chair Grassley took issue with the guidance stating that "employers who continue providing qualified health benefits to their employees do not qualify for the retention credit unless they continue paying other qualifying wages," which runs counter to the Congressional intent. The letter was also signed by the SFC Ranking Democrat Wyden (D-OR) and Ways & Means Committee Chair Neal (D-MA).

Electronic Filing, Signatures for APA Program: The **IRS modified its procedures for filing documents and requests under its advance pricing agreement (APA) program** outlined under Revenue Procedures 2015-40 and 2015-41. The modifications

allow for electronic signatures and electronic submissions. The announcement also said: "With regard to questions about pending and executed APAs, the Advance Pricing and Mutual Agreement Program (APMA) is actively discussing various substantive and procedural issues with treaty partners, including such technical issues as the application of transfer pricing methods in periods of economic distress and the impacts of current economic conditions on specific industries, types of taxpayer, regions, etc. Stakeholders wishing to discuss these and other general issues with APMA are asked to contact the appropriate APMA Assistant Director.

Flexible Spending Arrangements (FSAs): The IRS issued **Notices 2020-29 and 2020-33, which extend the period for filing claims under flexible spending arrangements (FSAs) and dependent care assistance programs and allow taxpayers to make mid-year changes.** The IRS explained that the guidance addresses unanticipated changes caused by the COVID-19 pandemic and provides that previously provided temporary relief for high deductible health plans may be applied retroactively to January 1, 2020. It also increases for inflation the $500 permitted carryover amount for health FSAs to $550.

Retirement Savings: The **IRS issued a set of 14 FAQs on COVID-19-related relief for retirement plans and IRAs** focusing on §2202 of the CARES Act, which provides special rules for the use of retirement funds. The IRS said that it is preparing more formal guidance on this provision.

Tax Exempt Bonds Guidance: The IRS issued **Notice 2020-25, which temporarily expands the circumstances and time periods in which a tax-exempt bond that is purchased by its state or local governmental issuer is treated as continuing in effect without resulting in a reissuance or retirement of the purchased tax-exempt bond for purposes of §103 and §141-150.** The IRS also issued Revenue Procedure 2020-21, which provides temporary guidance on the public approval requirement under §147(f) for tax-exempt qualified private activity bonds. The IRS explains that, in light the COVID-19 pandemic, the guidance provides that a teleconference hearing as described in the guidance will be treated "as held in a location that, based on the facts and circumstances, is convenient for residents of the approving government unit for the purpose of §1147-1(d)(2) of the Income Tax Regulations."

RIC/REIT Guidance: The IRS issued **Revenue Procedure 2020-19, which provides temporary guidance on the "treatment of certain stock distributions by publicly offered real estate investment trusts (REITs) and publicly offered regulated investment companies (RICs)."** The IRS explains that the guidance modifies the safe harbor provided in Revenue Procedure 2017-45 "by temporarily reducing the minimum required aggregate amount of cash that distributee shareholders may receive to not less than 10 percent of the total distribution in order for §301 of the Code, by reason of §305(b) of the Code, to apply to such distribution." The temporary modification is effective solely with respect to distributions declared in April through the end of 2020.

Other Issues and Guidance

Debt/Equity Regulations: The IRS issued **final and temporary regulations under §385 and §752 on the treatment of intercompany debt for US federal income tax purposes.** The guidance adopts without substantive changes the text of the 2016 Proposed Regulations, which were controversial when they were issued because they arguably exceeded the authority granted to Treasury by Congress. There are **important issues which are reserved on** including the application of the regulations to foreign issuers of intercompany debt. Also, there are **significant exceptions** including for certain short-term cash pooling arrangements.

In a press release, Treasury stated that they intend to further revise and limit the original rules that were issued in 2016 after a series of high-profile corporate inversions, in which a US company becomes a foreign-parented entity by merging with a smaller non-US entity. After inverting, the company would create debt in its US operations and cause its US subsidiaries to pay interest to foreign affiliates, effectively shifting earnings from the US to foreign jurisdictions with lower tax rates. The Preamble to the regulations states that this "earnings stripping" is the core purpose of the new guidance, although the reach and scope of the rules is far broader and can impact non-inversion cases.

The 2016 proposed regulations included new documentation requirements for intercompany debt, as well as rules to recharacterize debt in some transactions as equity, which would not be a deductible payment. Taxpayers argued that the rules affected some legitimate transactions such as cash pooling, and the Treasury later issued proposed regulations with an exception for this activity. In 2017, Treasury included the 385 proposed regulations on a list of rules to review, and in December of 2017, the TCJA was enacted with changes to the limits on interest deductions under §163(j) with some taxpayers arguing that the proposed regulations were no longer needed. In 2018, Treasury announced that it would repeal the documentation rules, but continue to review the remaining 385 rules. In October 2019, Treasury announced that it would retain but pare back the remaining earnings stripping rules. In light of the fact that the CARES Act has temporarily loosened the 163(j) limitations, the 385 rules may have new significance.

The Final Regulations address earnings stripping primarily by making it more difficult to classify many intercompany loans as debt for US tax purposes. The rules apply to debt issued to a related entity by a domestic corporation or by certain "flow-through" entities but exclude debt between members of a consolidated group and adopt

> "The Final Regulations address earnings stripping primarily by making it more difficult to classify many intercompany loans as debt for US tax purposes."

threshold asset and other requirements to reduce the application to taxpayers other than large corporate groups. For this purpose, two entities are related if they belong to the same "expanded group," which generally means that they are directly, indirectly, or constructively connected through chains of 80% or greater ownership. The rules impose two principal restrictions on a taxpayer's ability to classify an instrument as debt for US tax purposes when issued within an expanded group by a domestic corporation or certain flow-through entities through the "Documentation Rules" and the "General Rule" and "Funding Rule."

NAFTA References for Tax Treaty Purposes: The IRS issued **Announcement 2020-06,** which explains how the IRS and Treasury will interpret references in US income tax treaties to the North American Free Trade Agreement (AFTA) once it is replaced by the Agreement between the United States, Canada and Mexico (USMCA), which is set to enter into force on July 1, 2020. The guidance explains that "once the USMCA goes into force, the IRS and Treasury will interpret any references to NAFTA in a US income tax treaty as a reference to the USMCA." Treasury and the IRS intend to confirm this procedure with countries that have a tax treaty containing references to NAFTA.

Extension of Deadlines for Accessing Wind and Solar Tax Credits: A letter from the Office of Legislative Affairs at Treasury suggests that **Treasury will be extending the deadlines for both the investment tax credit (ITC) and production tax credit (PTC) programs,** stating that it "plans to modify the relevant rules in the near future." The short letter did not provide any details on the extension, but it was written in response to a letter from a bipartisan group of senators led by SFC Chair Grassley (R-IA) sent on April 23, 2020, requesting that Treasury extend the current four-year "continuous construction" safe harbor for the PTC and ITC by one year. The letter stated that the extension would allow more time for solar and wind developers to qualify for the federal programs intended to incentivize the construction of clear energy projects. An extension would benefit wind and solar developers who are currently being affected by supply chain disruptions and construction and permitting delays due to the COVID-19 pandemic.

New Procedures for Group Exemption Letter Program: The IRS issued **Notice 2020-36, which proposes a new revenue procedure to update its group exemption letter program.** The new revenue procedure modifies and supersedes Revenue Procedure 1980-27 by setting forth updated procedures under which recognition of exemption from federal income tax for organizations described in §501(c) may be obtained on a group basis for subordinate organization affiliated with and under the general supervision or control of a central organization. Until the new revenue procedure is finalized and published, Revenue Procedure 1980-27 continues to apply, but the IRS will not accept any requests for group exemption letters starting on June 17, 2020, until the new procedures are established.

Deductions for Estates and Non-Grantor Trusts: The IRS issued **proposed regulations that clarify that certain deductions allowed to an estate or non-grantor trust are not miscellaneous itemized deductions,** and, therefore, not affected by the suspension of the deductibility of miscellaneous itemized deductions for taxable years beginning after December 31, 2017, and before January 1, 2026. The proposed regulations also provide guidance on determining the character, amount, and allocation of deductions in excess of gross income succeeded to by a beneficiary on the termination of an estate or non-grantor trust.

LB&I Practice Units: The **LB&I Division released Practice Units on three topics** including:

- Overview of §986(c) Gain or Loss Prior to the TCJA to address **foreign currency gain or loss** on the distribution of previously taxed income by a controlled foreign corporation to a US shareholder
- **§481(a) Adjustments for §263A costs** that require the IRS to compute an §481(a) adjustment and notify the taxpayer that it is treating the accounting method issue as a change in accounting method and also provides examples of such change
- **Foreign Earned Income Exclusion Adjustment** with the materials outlining the steps on calculating the exclusion adjustment, which include: (1) determining the amount of foreign income excluded; (2) determining the amount of foreign taxes allocable to excluded foreign income; and (3) computing the foreign earned income exclusions adjustment.

International Issues

OECD - Adoption of a Global Minimum Tax & Digital Taxation

The OECD continues its work on establishing new rules to identify where taxes on multinationals should be paid (nexus rules) and on what portion of profits these entities should be taxed (profit allocation rules) under Pillar One. The goal is to ensure that multinational enterprises (MNEs) conducting ongoing and significant business in places where they may not have a physical presence can be taxed in those jurisdictions.

The **next full Inclusive Framework meeting, which was scheduled for July, has now been postponed to October** due to the COVID-19 pandemic, although there may be a virtual meeting in July. The delay has resulted in speculation that the OECD will not meet its deadline of reaching a global agreement by the end of the year.

The goal of the next meeting is for countries to sign off on a complete political agreement covering Pillars One and Two, which will now happen just before the meeting of the G20 leaders in November. Pascal Saint-Amans, the Director of the OECD's Center for Tax Policy, acknowledged that the project may now take longer than initially planned and stated that it may be a staged process with some decisions shifting into 2021.

A publication from TruePartners CONSULTING

Prepared in conjunction with Susan Rogers of Potomac Law Group PLLC

> Bruno Le Maire, the French Finance Minister, has stated that France will proceed with its planned digital service tax only if the OECD fails to agree on a global plan by 2021.

One of the most challenging issues to resolve relates to Pillar One, which involves a reallocation of certain profits of consumer-facing businesses and automated digital services, and the declaration by the US last fall that it would only accept Pillar One as a "safe harbor" with China now reportedly agreeing with the US position. The Inclusive Framework countries agreed to defer a decision on the US proposed amendments to Pillar One until after the framework of the proposal was agreed upon, but the need for that agreement is coming soon if the work is to be completed by the end of 2020.

France: Bruno Le Maire, the French Finance Minister, has stated that **France will proceed with its planned digital service tax only if the OECD fails to agree on a global plan by 2021.** He says that France is firmly committed to the OECD's effort to design tax rules for the digital economy, but they continue to look to the end of 2020 as a deadline for the global plan to be confirmed. The US threatened trade sanctions in response to the implementation of France's digital service tax, but the decrease in trade from the COVID-19 pandemic may have lessened the impact of any possible sanctions.

European Union

In response to the COVID-19 pandemic, the **European Commission (EC) proposed delaying reporting deadlines for intermediaries or relevant taxpayers under EU Directive 2018/822 (DAC 6) by three months (from July to October)** and delaying the exchange of information under DAC 6 until the beginning of 2021. The DAC 6 directive requires intermediaries (or, under certain circumstances, relevant taxpayers) to provide information on reportable cross-border transactions to the appropriate tax authorities if they have features commonly seen in schemes to avoid or evade tax. The tax authorities, in turn, must exchange information with their European counterparts through an EU portal. The European Council must adopt the EC proposal in order for it to take effect, and the Member States would have to agree to it.

The **EC also proposed delaying the entry into force of the VAT e-commerce package** by six months from January 1, 2021, to July 1, 2021. The new rules provide that all business-to-consumer (B2C) sales of goods to EU consumers would be taxed in the destination member state. Formal adoption of the proposal requires action by the European Parliament and the EU Council.

The **EC released reports that name six EU countries as having features of their tax systems that enable aggressive tax planning** including Cyprus, Hungary, Ireland, Luxembourg, Malta, and the Netherlands. The reports offer recommendations on how the jurisdictions can improve their legal systems.

Contact Information:

Jason Carter
Director
True Partners Consulting LLC
(312) 235-3307
Jason.Carter@TPCtax.com

Susan L. Rogers
Partner
Potomac Law Group, PLLC
(202) 492-3593
srogers@potomaclaw.com

©2020 True Partners Consulting LLC. All rights reserved. Printed in the USA. True Partners Consulting is a registered trademark in the U.S. and several international jurisdictions. Any tax advice contained in this communication (or in any attachment) is not intended or written to be used, and cannot be used by any taxpayer, for the purpose of avoiding U.S. federal, state, or local tax penalties or promoting, marketing, or recommending to another party any transaction or matter addressed in this communication (or any attachment). The information contained herein is for informational purposes only and is based on our understanding of the current tax laws and published tax authorities in effect as of the date of publishing, all of which are subject to change. You should consult with your professional tax advisor to discuss the potential application of this subject matter to your particular facts and circumstances.