International Tax

INTRODUCTION

In 2024, FustCharles continued our commitment to talent development, innovation, and teamwork to provide our clients with a best-in-class service experience. As we turn the page on 2024, there is plenty of uncertainty in the tax landscape. Many TCJA provisions are set to expire at the end of 2025, however as Republicans hold the White House, and have a slim majority in both chambers of Congress, there is an increased likelihood that 2025 will have some level of tax legislation through the budget reconciliation process.

FustCharles tax professionals grasp the intricate connections between evolving laws, economic dynamics, and the tax implications of various business decisions, and are well-positioned to serve as strategic advisors, steering companies toward success. Tax planning remains a vital aspect for businesses seeking to optimize cash flow by managing their long-term tax obligations.

Our 2024 Year-End Tax Planning Guide delves into effective tax strategies, considering recent administrative guidance and potential legislative changes that are currently under review. For further information and assistance, please reach out to a member of our expert tax team.

Unless explicitly stated otherwise, the information provided in this guide is based on existing tax laws and policies as of the publication date, and it may be subject to adjustments in response to future legislative or tax policy changes.

1) Proposed Dual Consolidated Loss (DCL) Regulations

The Department of the Treasury and the IRS on August 6 released proposed regulations on the dual consolidated loss (DCL) rules and their interaction with the Pillar Two global taxing regime. The proposed regulations also make several changes to how DCLs are calculated and introduce a new disregarded payment loss rule.

DCL Rules

The DCL rules apply to ordinary losses of a dual resident corporation (DRC) or a separate unit. A separate unit for purposes of the DCL rules is a foreign branch or hybrid entity that is owned by a domestic corporation. S corporations are not subject to the DCL rules, and domestic corporations will be treated as indirectly owning a separate unit that is owned by a partnership or grantor trust.

Subject to certain exceptions, such as certifying no foreign use, under Section 1503(d), a DCL of a DRC or separate unit generally cannot be used to offset U.S. taxable income of a domestic affiliate (no "domestic use"). This means that the DCL may be used only for U.S. federal income tax purposes against the income of the DRC or separate unit that incurred the DCL.

Proposed Regulations

The proposed regulations provide guidance in the following areas:

- DCLs and the interaction with Pillar Two
- Calculation of DCLs, including the following:
    - Removal of U.S. inclusions, dividends (including under Section 1248), gain on the sale from stock, as well as deductions (including under Section 245A) attributable to such income.
    - Intercompany transactions, such that if a member of a consolidated group is a DRC or a U.S. member that owns a separate unit, the counterparty consolidated group member's income or gain on the intercompany transaction will not be deferred.
    - Clarification that items that are not (and will not be) on the books and records of the separate unit are not included in the separate unit's income or DCL calculation.
- New disregarded payment loss rule.

Disregarded Payment Loss Rules

A significant development in the proposed regulations is the introduction of a new set of disregarded payment loss (DPL) rules, which operate independently of the DCL rules. To address certain deduction/non-inclusion outcomes, the DPL rules would apply to some disregarded payments (interest, royalties, and structured payments) that are deductible in a foreign country but are not included in U.S. taxable income because the payments are disregarded. The DPL rules would require a consenting domestic owner of a disregarded payment entity to include in U.S. taxable income the amount of any DPL, subject to certain calculation requirements, if a triggering event occurs within 60 months. The new DPL rules will likely have the significant effect of creating deemed income recognition in the U.S. without any corresponding deduction or basis increase.

Since no express statutory authority exists for the new DPL rules, under the proposed regulations, Treasury would implement the DPL rules in coordination with the entity classification election rules under Treas. Reg. §301.7701-3(c), which means that when a specified eligible entity either elects to be disregarded for U.S. tax purposes or defaults to a disregarded entity under the general rules of Treas. Reg. §301.7701-3(b), the domestic owner would be deemed to consent to the new DPL rules.

Effective Dates

The proposed regulations would generally apply to tax years ending on or after August 6, 2024.
The DPL consent rules would apply to the acquisition and formation of new entities, as well as entity classification elections filed, on or after August 6, 2024. For entities already in existence, the DPL consent rules would apply as of August 6, 2025, which would allow taxpayers time to restructure their existing operations before the DPL rules enter into effect.

The intercompany transaction regulations would apply to tax years for which the original U.S. income tax return is due without extensions after the date the final DCL regulations are published in the Federal Register. This means that if the final regulations are published by April 15, 2025, they would apply to calendar year 2024.

Once the proposed regulations are finalized, taxpayers can choose to apply them retroactively to open tax years, subject to consistency requirements.

Planning Considerations

Although still in proposed form, the DCL proposed regulations are lengthy and complex and many of the changes will apply retroactively to calendar year 2024 once the proposed regulations are finalized. Taxpayers will need to closely monitor disregarded payment losses arising from interest, royalties, or other structured payments, to ensure timely certification, as well as potential income recognition. Additionally, taxpayers will need to consider adjustments to DCL calculations going forward to take into account the new rules regarding removing items that are not on the separate unit's books and records and U.S. inclusions, among other items. The removal of these items could have a significant effect by unintentionally creating a DCL or increasing the amount of any existing DCL, among other possible upshots.

BDO can help taxpayers consider the impact these proposed regulations could have on their DRCs or separate units before the regulations are finalized, allowing time for restructuring operations if necessary.

2) Tax Court Holding that Foreign Fund Engaged in U.S. Business Via Investment Manager Raises Planning Issues

The Tax Court in a November 15, 2023, decision held that a non-U.S. investment fund partnership was engaged in a U.S. trade or business through the activities of its U.S. investment manager that acted as its agent. Consequently, the partnership was liable for withholding taxes for the portion of its effectively connected income allocable to its foreign partners (*YA Global Investments LP V. Commissioner*, 161 T.C. No. 11).

Planning Considerations

Based on the court's rationale, investment funds with foreign partners should consider the following to reduce the risk of being subject to taxation because they're deemed to be engaged in a U.S. trade or business:

- Existing investment management agreements between U.S.-based asset managers and offshore partners and investors should be evaluated and possibly restructured in light of the *YA Global* case. New investment management agreements should not allow the investment fund to give interim instructions to the investment manager.
- Neither the investment fund nor the investment manager should receive any type of fee from a portfolio company. The investment fund should derive only a return on the capital invested. If an investment fund would receive fees from portfolio companies, care and consideration should be given to the implications of this case.
- The taxpayer should maintain documentation demonstrating reliance on tax advice, the basis for such reliance, and the specific date in which a prior filing position is modified and the reason for such modification. BDO can assist clients to determine the existence of a U.S. trade or business in cases where there might be exposure under the enumerated principles of the *YA Global* case.
- Because the partnership in *YA Global* failed to file the required Forms 8804, Annual Return for Partnership Withholding Tax (Section 1446), it was left open to assessment despite the fact that the statute of limitations had run out for partnership Form 1065 and the partners. BDO can assist clients evaluate whether to file a Form 8804 when there are foreign partners and potentially effectively connected income and a U.S. trade or business, perhaps even on a "protective" basis.

3) Preparing for the Impact of OECD Pillar Two Implementation

In December 2021, the OECD released the framework for the Pillar Two global minimum tax. These rules – known as the global anti-base erosion (GloBE) model rules -- are intended to ensure multinational enterprises (MNEs) with global revenues above EUR 750 million ($800 million) pay a 15% minimum tax rate on income from each jurisdiction in which they operate. This minimum tax is imposed either on the ultimate parent entity through the income inclusion rule (IIR) or on another operating entity in a jurisdiction that has adopted the rules through the undertaxed payments rule (UTPR). Additionally, many jurisdictions could impose a qualified domestic minimum top-up tax (QDMTT) on profits arising within their jurisdiction.

Common structures likely to be impacted by these rules include:

- Tax havens, low-tax jurisdictions, and jurisdictions with territorial regimes
- Notional interest deduction regimes
- Intellectual property (IP) boxes and other incentives regimes
- Low-taxed financing, IP, and global centralization arrangements

Every global organization within the revenue scope needs to address Pillar Two, with a differing landscape depending on that organization's profile and footprint. Even if an MNE is not subject to a top-up tax, it

will still need to demonstrate that it falls below the threshold. Therefore, large MNEs should expect a significant increase in their compliance burden, as the rules require a calculation of low-taxed income based on the accounting income by constituent entity on a jurisdictional basis and reporting of the Pillar Two calculation to the tax authorities.

Implementation Timeline

The OECD does not legislate or implement laws. However, at least 25 jurisdictions have enacted laws adopting the OECD's Pillar Two rules into domestic legislation, and more are expected to follow. Many of these laws are effective January 1, 2024; some jurisdictions -- for example, some EU member states -- back-dated the effective date to January 1, 2024.

The jurisdictions that have already enacted Pillar Two rules include:

- Canada
- EU countries (including France, Germany, Ireland, Italy, Luxembourg, and the Netherlands), with the exception of some smaller countries, such as the Baltic states, that have opted to exercise their right to delay implementation of the Pillar Two rules to 2029
- Japan (applying to fiscal years beginning on or after April 1, 2024)
- Norway
- South Korea
- Switzerland (the rules include only a QDMTT that is effective January 1, 2024, with an income inclusion rule (IIR) expected to become effective January 1, 2025)
- United Kingdom

Significant markets that have yet to implement Pillar Two include Brazil, China, India, and the U.S.; however, the rules may still apply to MNEs headquartered or otherwise operating in these jurisdictions if they have operations in a jurisdiction that has implemented the rules.

The OECD published additional administrative guidance on the application of the Pillar Two rules on June 17, 2024. The new guidance supplements the previously released commentary and the first three installments of administrative guidance. This guidance addressed a number of issues under the GloBE rules, including:

1. The application of the recapture rule applicable to deferred tax liabilities (DTL), including how to aggregate DTL categories and methodologies for determining whether a DTL reversed within five years.
2. Clarification on how to determine deferred tax assets and liabilities for GloBE purposes when the rules result in divergences between GloBE and accounting carrying value of assets and liabilities.
3. The cross-border allocation of current and deferred taxes, allocation of profits and taxes in certain structures involving flow-through entities, and the treatment of securitization vehicles.

The new guidance provides additional detail on how the GloBE rules are intended to operate for MNEs. This administrative guidance will be incorporated into the commentary to the GloBE model rules.

Planning Considerations

Now that the GloBE rules are in effect in a significant number of jurisdictions, MNEs that may be within the scope of the rules should consider the following steps:

- Undertake an impact assessment to determine high-risk areas and identify the potential impact on effective tax rate (ETR) and cash tax.
- Keep ongoing communications with the board of directors and other stakeholders.
- Assess the impact on compliance and design a roadmap to implement a plan for Pillar Two compliance.

FustCharles can assist MNEs with:

- Impact assessments and modeling
    - Explain, evaluate, and communicate appropriate Pillar Two responses
    - Model ETR and cash tax impact, as well as supply chain and broader organizational effects
    - Identify structuring options for the capital and operational supply chain
    - Identify data and compliance implications and a roadmap for Pillar Two readiness
    - Assist with compliance efforts

- ASC 740 consultation
    - Assist in addressing specific accounting complexities

- Operational and legal restructuring and simplification
    - Assist with legal and operational restructuring and simplification to address the ETR impact and additional compliance obligations
    - Perform transfer pricing analysis to ensure optimization for Pillar Two purposes

- Technology implementation
    - Define data requirements and sourcing
    - Assist with selection and implementation of technology for calculations and compliance
    - Define and integrate data and processes with existing ecosystem and obligations

- Communication
    - Prepare board presentations on the impact of Pillar Two

4) Section 987 Regulations Expected to be Finalized Before Year-End

The Treasury Department and the IRS have announced their intention to finalize the 2023 proposed regulations under Internal Revenue Code Section 987 by the end of calendar year 2024. This will have significant implications for taxpayers that have a qualified business unit that uses a functional currency different from its owner (a “Section 987 QBU”).

Background

On November 9, 2023, the Treasury Department and the IRS issued proposed regulations providing guidance under Section 987 and related provisions (Sections 861, 985 through 989, and 1502) relating to the determination of taxable income or loss and foreign currency gain or loss with respect to Section 987 QBUs.

The 2023 proposed regulations include three key elections:

- An election to treat all items of a Section 987 QBU as marked items (the "current rate election");
- An election to recognize all foreign currency gain or loss with respect to a Section 987 QBU on an annual basis (the "annual recognition election"); and
- An election to recognize the pretransition Section 987 gain or loss ratably over 10 years (the "10-year installment election").

Terminations After November 9, 2023

The 2023 proposed regulations provide that the effective date will be accelerated regarding any QBU that terminates after the date the proposed regulations were issued, November 9, 2023. The effective date will be immediately before such terminations. Generally, gains upon termination would be recognized immediately, while losses may be deferred or potentially lost depending on the facts. Any Section 987 termination after November 9, 2023, and before the proposed regulations are finalized should be reviewed to determine the consequences of any gain or loss.

Transition to Final Regulations

The 2023 proposed regulations provide a transition rule that will require all QBUs to be deemed terminated and the calculation of a pretransition Section 987 gain or loss as of 12/31/2024 for calendar year taxpayers. The methodology used to calculate the amount of pretransition Section 987 gain or loss is determined based on whether or not the taxpayer has historically applied an eligible pretransition method.

The 2023 proposed regulations provide that eligible pretransition methods include:

- The 1991 proposed regulations;
- The 1991 proposed regulations applying an "earnings only" method, as long as that method has been consistently applied to all QBUs; and
- Any other reasonable method consistently applied that results in the same amount of Section 987 gain or loss as the 1991 proposed regulations.

No Eligible Pretransition Method

If a taxpayer has not applied an eligible pretransition method (including doing nothing) then the 2023 proposed regulations require the pretransition Section 987 gain or loss to be computed using a "simplified method." This method is generally a simplified foreign exchange exposure pool (FEEP) computation that requires taxpayers to determine the net equity of each QBU for the initial year of each QBUs existence translated into the functional currency of the home office owner of such QBU. Such net equity is compared to the Dec. 31, 2024, net equity value, also translated into the home office functional currency. The

difference between these amounts is then adjusted for Section 987 gains and losses recognized over the life of the QBU to determine the amount of pretransition gain or loss.

The source and character of the pretransition Section 987 gain or loss is based on the tax book value (asset method) of Treas. Reg. §1.861-9. Taxpayers may make an election to recognize the pretransition loss over 10 years. Alternatively, without the election, pretransition gains will be treated as unrecognized Section 987 gain or loss that will be recognized upon remittance, and pretransition losses will generally be treated as suspended losses and recognized to the extent that section 987 gains are recognized in the future.

Eligible Pretransition Method

If a taxpayer has been applying Section 987 using an eligible pretransition method, then that method should be followed to determine the amount of pretransition Section 987 gain or loss. The source and character of the pretransition Section 987 gain or loss is based on the tax book value (asset method) under Treas. Reg. §1.861-9. Taxpayers may make an election to recognize the pretransition loss over 10 years. Alternatively, without the election, pretransition gains and losses will be treated as described above.

Planning Considerations

Once the proposed Section 987 regulations are finalized, the effective date is expected to be Dec. 31,2024; however, some determinations may be made before the regulations are effective. For example, determining if an eligible method has been established will be important in calculating the amount of pretransition Section 987 gain or loss. If an eligible method has not been established, then taxpayers will need to complete the calculations as described above over the life of each QBU. Taxpayers need not wait until 2025 to complete these calculations and may get started on the calculations immediately.

Once the regulations are effective, the FEEP approach requires taxpayers to acquire balance sheet information for each QBU. Obtaining this balance sheet information may involve leveraging multiple accounting systems and taxpayers may want to start reviewing how this information will be obtained sooner rather than later.

Proactive tax planning and seamless tax compliance are essential components of financial success. At FustCharles, we are dedicated to providing year-round support, ensuring you stay informed about emerging opportunities, evolving tax laws, and optimal strategies. Our commitment is to guide you towards the most advantageous course of action aligned with your objectives, ultimately contributing to your business's financial well-being.

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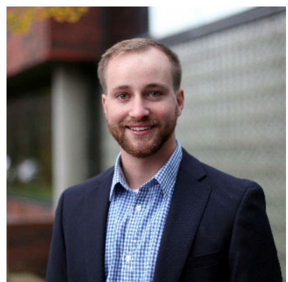

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