2023 YEAR-END TAX PLANNING GUIDE

INTERNATIONAL TAX

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CERTIFIED PUBLIC ACCOUNTANTS

CONTENT

This guide identifies tax strategies and considers how they may be influenced by recent administrative guidance and potential legislative changes that remain under consideration. Unless otherwise noted, the information contained in this article is based on enacted tax laws and policies as of the publication date and is subject to change based on future legislative or tax policy changes.

Preparing for the Impact of OECD Pillar Two Implementation

The OECD released the framework for the Pillar Two global minimum tax in December 2021. The Pillar Two model rules that were subsequently issued are intended to ensure that 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 in the ultimate parent entity through the income inclusion rule (IIR) or in 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.

Some of the common planning arrangements and tax regimes likely to be impacted by these rules include:

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

Every global organization within the model rules' revenue scope needs to address the potential impact of Pillar Two, and the landscape for each MNE will look different, 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 set by the model rules. Therefore, large MNEs should expect a significant increase in their compliance burden, because the rules require a calculation of low-taxed income based on accounting income by constituent entity on a jurisdictional basis, as well as reporting of the Pillar Two calculation to the tax authorities.

Implementation Timeline

The OECD framework originally proposed implementation of the IIR in 2023 and the UTPR in 2024. The EU recently proposed that implementation of the IIR be postponed to 2024 to provide EU member states more time to implement the rules in domestic legislation. Work on the implementation into domestic law is well underway in many jurisdictions, including all EU member states, with most adhering to a planned entry into force in 2024. It is important to continue to monitor global developments to determine which jurisdictions will keep to this timetable.

Actions MNEs Can Take

- Undertake an impact assessment to determine high-risk areas, and identify the potential impact to the effective tax rate and cash tax;
- Continue ongoing communication with the board of directors and other stakeholders;
- Identify any need for remedial action in the next 3-6 months (if required), including restructuring and simplification of legal and operating structure;
- Assess the impact on compliance and design a roadmap to implement a plan for Pillar Two compliance; and
- Identify planning opportunities to maintain certain tax structures or positions including use of attributes, financial accounting structure, capital structure, and related situations.

How a Tax Advisor Can Help

Impact assessments and modeling

- Explain, evaluate, and communicate appropriate Pillar Two responses;
- Model ETR and cash tax impact, 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; and
- Assist with compliance.

ASC 740 consultation

- Assist in addressing specific accounting complexities.

Operational and legal restructuring and simplification

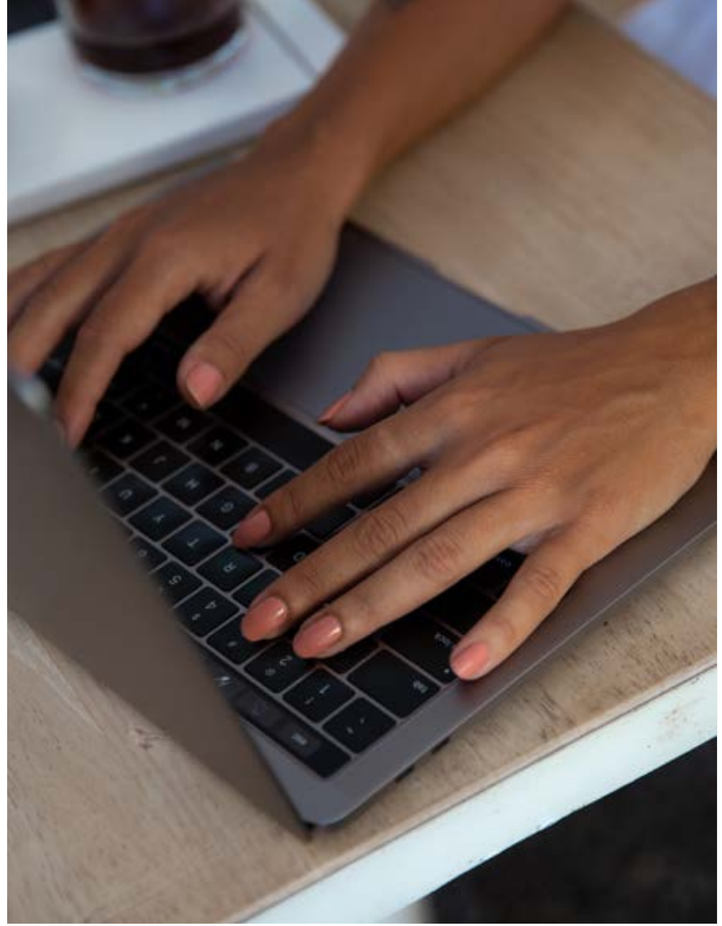
- Assist with legal and operational restructuring and simplification to address the ETR impact and additional compliance obligations; and
- Perform transfer pricing analysis to ensure optimization for Pillar Two purposes.

Technology implementation

- Define data requirements and sourcing;
- Assist with selecting and implementing technology for calculations and compliance; and
- Define and integrate data and processes with existing ecosystem and obligations.

Communication

- Prepare board presentations on the impact of Pillar Two



Potentially Significant Supreme Court Case Challenges Constitutionality of Section 965 Transition Tax

The Supreme Court of the United States has agreed to review the constitutionality of the "transition tax" in IRC Section 965, added by the 2017 Tax Cuts and Jobs Act. Section 965 imposed a one-time tax on some unrepatriated earnings and profits of certain foreign corporations.

The specific question that has been presented to the Court in the case of Moore v. United States is whether the tax imposed on the deemed repatriation of such earnings and profits under IRC Section 965 is constitutional. The taxpayers have argued that because the tax is imposed on unrealized income, it violates the 16th Amendment to the U.S. Constitution. The taxpayers lost in U.S. District Court for the Western District of Washington, and again on appeal in the U.S. Court of Appeals for the Ninth Circuit. The taxpayers appealed to the Supreme Court, which granted certiorari on June 26, 2023.

Section 965 operated by increasing the subpart F income for the last taxable year of a "specified foreign corporation" that began before January 1, 2018, by the greater of the accumulated post-1986 deferred foreign income of the corporation as of (1) November 2, 2017, and (2) December 31, 2017. The accumulated post-1986 deferred income is generally the earnings and profits of the corporation accumulated in taxable years beginning after December 31, 2017.

Under Section 965, each U.S. shareholder (generally a U.S. person who owns 10% or more of the total combined voting power of a foreign corporation) of a specified foreign corporation was required to include in income its pro rata share of such subpart F income in its year in which or with which the taxable year of the foreign corporation ended and pay a tax on such income at reduced rates. In the case of a U.S. shareholder with the calendar year as its taxable year, the inclusion year was 2017 with respect to a specified foreign corporation with the calendar year as its taxable year and 2018 with respect to specified foreign corporation with other taxable years. The transition tax was subject to reduction by net operating losses, foreign tax credits, and other credits. A taxpayer was entitled to elect to pay the transition tax over eight years.

Actions Taxpayers Can Take

Consider filing protective refund claims for any year impacted by Section 965 to safeguard a possible right to a refund should the Court rule that the Section 965 tax is unconstitutional.

Protective refund claims preserve a taxpayer's right to claim a tax refund when the right to the refund is contingent on future events — such as a court decision — that may not occur until after the period of limitations expires. The protective claim concept is not included in the Internal Revenue Code or Treasury regulations but is established by case law. The years impacted by Section 965 will include each inclusion year, each year for which an installment payment was made, and each year impacted by adjustments made to tax attributes (e.g., net operating losses, foreign tax credits) used in an inclusion year.

How a Tax Advisor Can Help

Filing Protective Refund Claims

- Assess statute of limitations matters, consider best posture for year(s) for filing refund claims, and assist in preparation of the protective refund claims with appropriate disclosures.

Modeling and Analysis and Final Refund Claims

- Model implications of Section 965 being ruled unconstitutional (if this occurs) in later years because tax attributes would change;
- Address all items impacted by a ruling assuming a refund is claimed and issued; and
- Provide continued support in dealings with the IRS during processing of the refund claims.

Legal Entity Rationalization

As global tax developments take center stage, multinational enterprises (MNEs) are at risk of evolving into more complex tax profiles and incurring increased total tax liability. Additionally, with rising interest rates and significant inflation taking hold, MNEs are preparing for a reduced growth environment. As a result, tax planning and cash savings are becoming priorities. The current economic and global tax environments have renewed the interest of many MNEs in considering consolidating and simplifying organizational profiles to reduce tax and business challenges, among other opportunities.

A number of MNEs with large and complex legal and operating structures that have been built up through acquisitions and organic growth have found that the original purposes of the structures are no longer relevant; for example, historic deferral or repatriation strategies may no longer be relevant given global tax reform. As a result, those MNEs face many challenges, including:

- Increased substance scrutiny (local country requirements, EU/OECD grey and blacklists, treaty abuse scrutiny, ATAD 3 shell company directive);
- Enhanced disclosure requirements (country-by-country reporting, mandatory disclosure rules, ATAD 3 shell company directive, Pillar Two, and potentially U.S. CbC GILTI rules); and
- Significant costs incurred to maintaining certain legal entities and structures (internal costs, such as salaries, operational, and administrative costs, as well as external costs, such as audit and tax compliance).

Those challenges can potentially be reduced or mitigated through proper legal entity rationalization (LER) planning.

LER Planning and Considerations

Many options can be considered when contemplating LER planning for an MNE, including:

- Elimination of tiered foreign holding companies;
- Consolidation of foreign subsidiaries under a single foreign holding company;
- Consolidation of foreign subsidiaries directly under the U.S. parent; and
- Consolidation of foreign subsidiaries to reduce legal entities to one per jurisdiction.

When contemplating an LER planning strategy, it is important to keep in mind both tax and non-tax considerations. Tax considerations include the impact on tax attributes, future repatriation mechanisms and the impact on dividend withholding tax, the impact on the U.S. tax profile, and the U.S. tax costs of restructuring. Non-tax considerations include the future divestment or commercial and legal need to keep businesses separate, historic liabilities and claims (such as pension liabilities), human resources, and union requirements and approvals needed.

Benefits of LER Planning

Post-implementation, the benefits of proper LER planning can be significant. With a future state that significantly reduces redundancy, MNEs can align their legal and capital structure with strategic priorities, effectively evaluate the performance of underlying assets, align the corporate structure with its core business functions, effectively circulate working capital and repatriation, and significantly reduce costs.

How a Tax Advisor Can Help

A tax advisor can help MNEs assess their organizational structures, as well as tax and business needs, to consider opportunities for LER planning and, as a result, help MNEs reduce costs and align their corporate structure with future global goals.

International Tax Planning in a Distressed Economy

A distressed economy can have major tax implications for U.S. companies with foreign operations. In a distressed economy, U.S. companies can utilize planning opportunities to access cash and/or claim certain tax benefits. Some of these planning opportunities include:

- Accessing CFC cash by borrowing from a controlled foreign corporation (CFC) (or pledging CFC stock to secure third-party debt) without causing an inclusion under Section 956.
- Claiming an ordinary worthless stock loss on an insolvent CFC under Internal Revenue Code Section 165(g)(3).
- Importing built-in loss property through an inbound liquidation or reorganization of a CFC.
- Preserving net operating losses, foreign tax credits, and Section 250 deductions by deconsolidating.
- Repatriating previously taxed earnings and profits to trigger Section 986(c) foreign exchange losses.
- Restructuring so that CFCs are no longer directly or indirectly owned by U.S. entities.
- Accelerating foreign-source income to utilize foreign tax credits.
- Capitalizing interest expense into cost of goods sold to minimize the base erosion and anti-avoidance tax (BEAT).
- Increasing adjusted taxable income for Section 163(j).

This list identifies only some of the opportunities available to a company operating in a distressed economy. Each opportunity needs to be evaluated based on a taxpayer's specific facts and circumstances.

How a Tax Advisor Can Help

A tax advisor can help multinational companies by assisting in reviewing their international operations to identify opportunities, model potential tax benefits, analyze tax positions and risks, and assist in the preparation of supporting documentation.

Final Foreign Tax Credit Regulations

The 2021 final foreign tax credit (FTC) regulations, released in December 2021, made significant changes to the former FTC regulations that had been on the books since 1983. While the 2021 FTC regulations generally followed the proposed regulations released on September 29, 2020, the 2021 FTC regulations included several important changes.

Of particular significance to U.S. taxpayers with cross-border activities, the 2021 FTC regulations changed the cost recovery element of the net gain requirement and added a new attribution requirement to the existing net gain requirement for the determination of whether a foreign levy constitutes a creditable foreign income tax under Internal Revenue Code Sections 901 and 903. The new attribution rule requires that foreign taxes follow source rules similar to the source rules under U.S. federal income tax law.

The IRS attempted to alleviate taxpayers' concerns regarding the new stringent requirements of the 2021 FTC regulations by releasing technical corrections to the cost recovery element of the net gain requirement, as well as subsequent proposed regulations providing safe harbors for both the cost recovery element of the net gain requirement and the royalty sourcing rule under the attribution requirement. Despite the IRS's efforts, however, many concerns remained.

Notice 2023-55

On July 21, 2023, the IRS released Notice 2023-55. The guidance offered taxpayers a choice to largely follow the former FTC creditability rules for tax years 2022 and 2023 (subject to certain carveouts, such as for digital services taxes (DSTs) and other gross basis taxes discussed below), while the IRS considers potential changes to the 2021 FTC regulations.

Under Notice 2023-55, if a foreign tax was creditable prior to the 2021 FTC regulations, it should generally still be creditable until December 31, 2023. No affirmative election or statement is required to be filed to claim the temporary relief under Notice 2023-55. Taxpayers may apply the temporary relief to foreign taxes paid or accrued, including by a controlled foreign corporation (CFC), in taxable years beginning on or after December 28, 2021, and ending on or before December 31, 2023.

Nonconfiscatory Gross Basis Tax Rule

Under former Treas. Reg. §1.901-2(b)(4)(i), certain gross basis taxes qualified as income taxes under the net gain requirement rather than having to qualify as an in lieu of tax under Section 903 (the "nonconfiscatory gross basis tax rule"). This rule applied if costs and expenses would almost never be so high as to offset gross receipts or gross income entirely (i.e., almost certain to never incur a loss after payment of the tax) and applied to all foreign income taxes under Section 901, whether generated by the U.S. taxpayer directly or indirectly through CFCs. Foreign taxes that were not creditable under Section 901, such as true gross basis withholding taxes, could potentially qualify as an in lieu of tax under Section 903.

Under Notice 2023-55, the nonconfiscatory gross basis tax rule was revised to no longer apply to gross basis income taxes, unless the foreign tax applies only to gross investment income (not trade or business or wage income). This revision applies to all foreign income taxes under Section 901, whether generated by the U.S. taxpayer directly or indirectly by CFCs and does not apply to true withholding taxes under Section 903, which are gross basis taxes by nature. Gross foreign taxes that are excluded under Section 901 might qualify as an in lieu of tax under Section 903, assuming that the foreign tax qualifies under the revised substitution or covered withholding tax tests; however, DSTs generally won't qualify under Section 903, because they would fail the non-duplication requirement.

2024 Considerations

The temporary relief provided by Notice 2023-55 is scheduled to expire on December 31, 2023. This is expected to adversely impact taxpayers with cross-border activities. If Treasury and the IRS do not extend the temporary relief provided by Notice 2023-55, taxpayers will be once again subject to the stringent requirements of the 2021 FTC regulations.

Taxpayers with calendar year-ends are best situated to benefit from Notice 2023-55, because it grants them relief from the 2021 FTC regulations through the 2024 compliance season. Conversely, taxpayers with fiscal year-ends after December 31, 2023, will need to consider creditability of foreign taxes under the 2021 FTC regulations for tax years outside of the relief period. If the IRS does not extend the temporary relief of Notice 2023-55, taxpayers with calendar year-ends will need to consider the impact of the 2021 FTC regulations on the creditability of their foreign taxes for January 2024 provisions and audits.

How a Tax Advisor Can Help

While Notice 2023-55 was welcome guidance, taxpayers should promptly consider whether their foreign taxes will qualify for temporary relief for tax years 2022 and 2023, assuming the foreign taxes are not the type that are excluded (such as DSTs or other gross basis taxes).

With the impending expiration of Notice 2023-55's temporary relief, taxpayers are on a countdown until the end of this year to address the potential implications of the 2021 FTC regulations on their January 2024 provisions if the IRS does not provide an extension of the relief or additional guidance on how the 2021 FTC regulations should be applied. Tax advisors can help taxpayers determine the creditability of foreign taxes under Notice 2023-55, as well as plan for the potential expiration of the temporary relief and the impact on the creditability of foreign taxes as a result.

Sec. 965(b) PTEP: Foreign Tax Credit Considerations

On March 31, the U.S. District Court for the Western District of Tennessee, in the case of FedEx Corp. v. United States, granted FedEx's motion for partial summary judgment over the denial of foreign tax credits (FTCs) related to earnings from profitable related foreign corporations offset by losses from other foreign corporations ("offset earnings"). With this ruling, the court invalidated the Treasury Department's transition tax regulation provision limiting the FTC on offset earning distributions from Internal Revenue Code Section 965(b) previously taxed earnings and profits (965(b) PTEP).

While Section 965(g), among other provisions, placed limitations on FTCs associated with income taxed under the transition tax, neither Section 965(g) nor any other section under the Tax Cuts and Jobs Act explicitly eliminated FTCs on offset earnings. The IRS and Treasury, however, issued a regulation denying FTCs for foreign taxes paid on those offset earnings.

FedEx argued that Section 960(a)(3) unambiguously provided an FTC for offset earnings because those earnings were never included in income under Section 951 and, therefore, the taxes remained available for use on a future distribution of previously taxed income.

The court ruled that under the plain language of the tax code, which is not ambiguous, FedEx is entitled to an FTC for foreign taxes paid on the offset earnings that were distributed as PTEP in 2018 and set aside the regulation.

Actions Taxpayers Can Take

- Review position on potential foreign tax credit claims. Determine if the company may be entitled to a refund of foreign taxes paid on offset earnings under Section 965.
- Evaluate the impact of the ruling on the company's tax positions. Determine if there is sufficient foreign-source income to access additional FTCs available from the ruling.
- Consider the potential impact of Moore v. United States on the ability to claim additional FTCs.

How a Tax Advisor Can Help

- Assist in assessing the impact of the FedEx case and associated tax positions taken regarding the FTC implications.
- Model various "what if" scenarios to validate analysis and better position taxpayers to utilize FTCs.

Contact Us

Lumsden McCormick meets the needs of individuals and businesses with a breadth of tax, audit, and consulting services, including annual tax planning, compliance, and wealth management strategies.

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