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INTERNATIONAL TAX UPDATE

Recent Developments

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Overview of Mexico's 2022 Tax Reform

Your presenter

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Recent Developments in U.S. International Tax

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  - Review of Final Foreign Tax Credit Regulations Issued January 4, 2022
    - The new "Jurisdictional Nexus Requirement"
  - Summary of international tax proposals in the Greenbook
    - Repeal of the base erosion and anti-abuse tax (BEAT)
    - Introduction of the undertaxed profits rule (UTPR)
    - Impact on global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII)
    - Expansion of the definition of foreign business entities
    - Expanded reporting requirements with respect to foreign financial institutions and digital assets

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Recent Changes to Foreign Tax Credit Regulations

- By way of background, US citizens and domestic corporations can take a credit for income taxes paid or accrued to a foreign country during a taxable year, subject to certain limitations.
- Before these changes, the definition of a creditable income tax notably did not include a requirement that the tax in question be levied on income with nexus (connection or relationship) to the taxing jurisdiction.
- Proposed regulations issued in 2020 floated a jurisdictional nexus requirement that would generally require the foreign country imposing a tax to have sufficient nexus to the taxpayer's activities or investments that give rise to the foreign taxes for the taxes to be creditable for US income tax purposes.
- This proposal drew negative attention from commentators who argued that a nexus requirement was inappropriate because under historical regulations the meaning of an 'income tax' refers to whether the tax is based on net income rather than its nexus to the country imposing the tax.

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Final Foreign Tax Credit Regulations Adopt Jurisdictional Nexus concept

- Regardless of negative reaction, the final regulations adopted the jurisdictional nexus concept, however, it was restyled as an attribution requirement.
- The new regulations also update the definition of “taxes in lieu of income taxes” which applies to taxes such as withholding taxes.
- Under the new nexus rules, foreign source-based taxes must apply sourcing rules similar to the US sourcing regime.
- The new attribution rule requires that the tax regime apply the arm’s-length principle to any allocations made with respect to intercompany transactions.

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Other Implications from Final Foreign Tax Credit Regulations

- The final regulations also require a foreign levy to meet the attribution requirement in order to qualify as an 'in lieu of' tax.

- This generally makes withholding taxes imposed on payments for services performed outside of the taxing jurisdiction, or withholding taxes imposed on royalties for the use of intangible property used outside of the taxing jurisdiction, non-creditable.

- Treasury regards digital service taxes (DSTs) as problematic, the attribution requirement is meant to limit such foreign tax credits, however, the regulations go beyond targeting DSTs and deny creditability for a broader spectrum of foreign taxes, many of which are of longstanding and have long been accepted as creditable in the US.

- In addition, if adopted, taxes under the OECD's pillar one Amount A (which is currently targeted for implementation in 2023) would not be creditable under these rules.

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Greenbook Proposed Alignment with OECD's Pillar Two

- Repeal and replace the base erosion and anti-abuse tax (BEAT) with an undertaxed profits rule (UTPR) that mirrors the OECD's Pillar Two's UTPR
  - The proposed UTPR targets foreign-parented multinationals operating in low-tax jurisdictions
  - The Build Back Better Act (BBBA) would have retained the BEAT but with several modifications
- There are two components of Pillar Two:
  - Income Inclusion Rule (IIR) — Imposes a top-up tax on a parent entity with respect to the low-taxed income of a member of its financial reporting group
    - Applies to income taxed below a 15% effective tax rate threshold
    - Implementation planned for 2023
  - UTPR — Denies deductions or requires an equivalent adjustment to tax liability to the extent that the low-taxed income of a member of the group is not subject to an IIR
    - Implementation planned for 2024

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Greenbook Proposed UTPR Aimed at Protecting U.S. Revenue

- Would apply only to financial reporting groups with at least $850 million in global annual revenue in at least two of the last four years (with certain de minimis exclusions)
- Would deny deductions to domestic group members to the extent necessary to effect a 15% tax rate in each foreign jurisdiction in which the group has profits
  - The disallowance would apply pro rata to all otherwise allowable deductions and after all other deduction disallowance provisions in the Code are applied
  - Excess amount of UTPR disallowance would be carried forward indefinitely
- Would not apply to income subject to an IIR that satisfies OECD rules
  - Including income subject to the GILTI regime
- Would also adopt a domestic minimum top-up tax that would apply when another jurisdiction adopts a UTPR
- Would be effective for taxable years beginning after December 31, 2023

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BBBA Baseline Assumed for GILTI and FDII

- The minimum tax rate used for purposes of Pillar Two's Income Inclusion Rule and Undertaxed Profits Rule will be 15%
  - The GILTI regime is intended to be a qualifying IIR under Pillar Two
- The FY2023 Treasury Greenbook assumes the BBBA as a baseline, indicating the retention of the IRC §250 deduction for FDII and reducing its percentage

	Current Law	Build Back Better Act (H.R. 5376)	FY2023 Treasury Greenbook
IRC §250 Deduction for GILTI	50%	28.5%	28.5%*
Corporate Tax Rate	21%	21%	28%**
GILTI Effective Rate	10.5%	15%	20%

*The FY2023 Treasury Greenbook retains the BBBA's reduced IRC §250 deduction percentage for GILTI
**The increased corporate tax rate would be effective for taxable years beginning after December 31, 2022

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Greenbook Proposed Additional Reporting for Taxable Units

- Would treat any taxable unit as a foreign business entity for IRC §6038 reporting purposes
  - Information would be reported separately for each taxable unit in a foreign jurisdiction
  - Penalties would also apply separately for any failures to report

- This proposal would facilitate the BBBA's shift to applying the GILTI, subpart F, and foreign tax credit (FTC) regimes on a jurisdiction-by-jurisdiction taxable unit basis by requiring information to be reported at the same level

- Would be effective for taxable years of a controlling U.S. person that begin after December 31, 2022, and to annual accounting periods of foreign business entities that end with or are within such taxable years of the controlling U.S. person

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Greenbook Additional Reporting for Foreign Financial Institutions

- Would require financial institutions to report:
  - Account balances for all financial accounts maintained at a U.S. office and held by foreign persons;
  - Gross proceeds from the sale or redemption of property held in, or with respect to, a financial account held by a foreign person; and
  - Information regarding certain passive entities and their substantial foreign owners

- Would expand the current reporting required with respect to U.S.-source income paid to accounts held by foreign persons to include similar foreign-source payments

- Would extend reporting to foreign digital asset accounts, which include any account that holds digital assets maintained by a foreign digital asset exchange or other foreign digital asset service provider

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