GIBSON DUNN

Tax Legislative, Regulatory & Enforcement Update

Presented by:

Michael Desmond
Lorna Wilson
Brian Hamano

California MCLE Marathon Blitz | January 2022

Overview

- The Tax Cuts and Jobs Act (TCJA) was signed into law in December 2017, marking the most significant change to federal tax law since the Tax Reform Act of 1986 and, in the area of cross-border tax, the most significant change since the enactment of the foreign passive income provisions of Subpart F in 1962

- With the election of President Biden in 2020, there was an expectation that some of the sweeping changes made by the TCJA might be rolled back
  - The "Green Book" legislative proposals released by the Biden Administration in May 2021 (summarized here) proposed to do just that, including a proposed increase in the corporate tax rate from 21% to 28%
  - The proposed corporate rate increase was part of a package of revenue raising measures included in the Green Book, focused mostly on businesses, that would have generated $4.1 trillion in new tax revenue in FY 2022 alone

- An evenly-divided Senate has created a different reality
  - A bipartisan $1.2 trillion infrastructure bill was signed into law on November 15, 2021
  - In November 2021, the House passed a $3 trillion "Build Back Better" bill focused on "social infrastructure," but that legislation remains pending in the Senate with an uncertain future

- Meanwhile, work remains under way at the Treasury Department and IRS to implement the TCJA, while IRS enforcement activity and tax litigation continues apace

Legislative Developments: Infrastructure Bill Signed Into Law

- On November 15, 2021, President Biden signed into law the Infrastructure Investment and Jobs Act (the "Infrastructure Bill," Pub. L. No. 117-58). The Infrastructure Bill allocates funding for roads and bridges, water infrastructure, resilience, internet and cybersecurity, among other areas.

- The Infrastructure Bill also includes, as revenue raising measures (summarized here), provisions that clarify and expand tax information reporting for certain transactions involving "digital assets," defined (subject to regulatory exceptions) to include:
  - "[A]ny digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary."

- The Infrastructure Bill includes two tax information reporting provisions applicable to "digital assets":
  - The definition of "broker" in 26 U.S.C. § 6045 is "clarified" to include "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person"; and
  - The IRS Form 8300 "cash reporting" requirements in 26 U.S.C. § 6050I, originally enacted as an anti-money laundering measure, are expanded to encompass transactions in "digital assets"

- The Joint Committee on Taxation estimated that these information report provisions would raise nearly $30 billion in additional tax revenue over a 10-year budget window

Legislative Developments: Build Back Better Act Passed the House

- On November 19, 2021, the U.S. House of Representatives passed H.R. 5376, the "Build Back Better Act," which would expand and make significant changes to a number of government benefit programs. Included in the legislation are four tax expenditure and revenue-raising subtitles:
  - Subtitle E: *Infrastructure Financing and Community Development*, including an expansion of the low-income housing tax credit
  - Subtitle F: *Green Energy* (prior version summarized here), including expanded production and investment tax credits, individual energy efficiency tax provisions, and electric vehicle credits
  - Subtitle G: *Social Safety Net*, including an expanded child tax credit, earned income tax credit and tax subsidies for health care coverage
  - Subtitle H: *Responsibly Funding Our Priorities* (aka tax increases), including:
    - For businesses, a new corporate alternative minimum tax tied to "financial statement income", a new a 1% excise tax on the value of stock repurchases, increased limitations on interest expense deductions, modifications to the computation of foreign tax credits and other outbound international tax provisions enacted in 2017, modifications to the base erosion tax also enacted in 2017, and expansion of the 3.8 percent Net Investment Income Tax to apply to all active business income for pass-through firms;
    - For individuals, a new 5% "surcharge" on income over $10 million and an additional 3% surcharge on income over $25 million;
    - Modification of various retirement plan provisions; and
    - Nearly $80 billion in additional long-term funding for the Internal Revenue Service

Legislative Developments: Build Back Better Act in the Senate

- On December 11, 2021, the Senate Finance Committee released draft text of proposed changes to the House-passed Build Back Better legislation, including technical modifications to the Infrastructure Financing and Green Energy titles

- Meanwhile, Finance Committee Chairman Ron Wyden (D-Oregon), has recently released discussion drafts of several tax measures that could also be in play as part of the Build Back Better legislation, including:
  - A provision that would annually tax (through a mark-to-market mechanism) accrued capital gains of individuals with $1 billion or more in total assets or $100 million or more in annual income;
  - Proposed changes to the tax treatment of partnership “carried interests” (similar provisions were included in an earlier version of the Build Back Better legislation); and
  - Numerous other changes to the partnership tax provisions in Subchapter K of the Code, including changes to the flexibility partnerships currently have in allocating items of income, deduction and credit among their partners and changes to the “disguised sale” rules applicable to certain partnership contributions

Legislative Developments: Build Back Better Act in the Senate

- On December 19, 2021, Senator Joe Manchin (D-WV) issued a statement saying that "*Despite my best efforts, I cannot explain the sweeping Build Back Better Act in West Virginia and I cannot vote to move forward on this mammoth piece of legislation*"

- With a Senate evenly divided between Democrats and Republicans, Senator Manchin's position has effectively blocked (at least for now) the Senate from considering the House-passed legislation

- Recent reports suggest further movement on the legislation in the Senate, although not necessarily movement forward:
  - Senator Krysten Sinema (D-Arizona) is reported to have new concerns with the high-income surtax included in the House-passed legislation applying to owners of pass-through entities; and
  - Senator Manchin is reported to be open to consideration of Chairman Wyden's mark-to-market tax on billionaires

- One of the key sticking points for Senator Manchin appears to be the cost of expanded, monthly child tax credit that was signed into law in March 2021 as a temporary measure included in the American Rescue Plan Act of 2021 (Pub. L. No. 117-2)
  - The expanded, monthly credit expired in December 2021. A 10-year extension of the expanded credit is included in the House-passed legislation at an estimated cost of $184 billion

Legislative Developments: International Tax Measures

- For nearly a decade, the Organisation for Economic Cooperation and Development ("OECD") has been spearheading an effort to reform international taxation, focused on measures that prevent or mitigate erosion of the income base on which countries impose tax. This "Inclusive Framework" on base erosion and profit shifting ("BEPS") has coalesced around two "pillars":
  - Under Pillar One, taxing rights on companies with profits over certain thresholds would be reallocated to "market jurisdictions." This would represent a dramatic shift away from the physical presence test that has dictated global taxing rights for decades; and
  - Under Pillar Two, a minimum 15% global tax rate would be agreed to by OECD member countries, applicable to multinational groups with >€750 million in consolidated financial statement income

- In 2017 the United States took several steps toward supporting the OECD's efforts by lowering its corporate tax rate from 35 percent to 21 percent and enacting a global 13.125% "minimum tax" (the "GILTI" tax) on foreign earnings of U.S.-based companies (increasing to 16.4% after 2025)

- After 2017, progress on the Inclusive Framework stalled as several countries pursued unilateral market-based or "digital tax" regimes that applied mainly to U.S.-based companies, raising the prospect of retaliatory trade measures and creating diplomatic tension with the United States

- In August 2021, however, an agreement was reached among 136 OECD member countries (including the United States) to move forward with Pillar One and Pillar Two.
  - The OECD has set a number of 2022 target dates for implementing Pillar One and Pillar Two, but significant work remains to be done to define the specifics of the two proposals and to secure treaty changes and legislation in countries across the globe to implement them

Regulatory Developments

- In the three years after enactment of the TCJA in 2017, the Treasury Department and the IRS completed more than 100 regulatory guidance projects to implement the TCJA, including (among many others):
  - Regulations to implement changes to the tax treatment of cross-border transactions, including the one-time “transition tax” in Code section 965, the GILTI minimum tax on global income in section 951A, the BEAT tax on outbound “base erosion” payments in section 59A, and the dividend received deduction in section 245A, all key parts of a new “quasi-territorial” tax regime;
  - Regulations to implement the qualified business income deduction provisions for pass-through entities in Code section 199A, designed to normalize the income tax treatment of pass-through entities with corporations; and
  - Regulations to implement the new Opportunity Zone provisions in Code section 1400Z, which provide tax incentives for making investments in underserved communities

- On September 9, 2021, the Treasury Department and IRS released their 2021-2022 Priority Guidance Plan, listing 193 projects targeted for completion by June 30, 2022, including:
  - Follow-up work to implement the TCJA, including regulations on the computation of foreign tax credits and regulations regarding previously taxed earnings and profits (“PTEP”); and
  - Regulations to regarding information reporting on virtual currency under Code section 6045, which will incorporate recently enacted provisions in the Infrastructure Bill

Tax Enforcement Update: TCJA Compliance Focus

- With the completion of all principal regulatory guidance to implement the TCJA and no major tax legislation passed into law in 2021, the IRS has remained focused on audits, compliance and enforcement

- In May 2020, the IRS' Large Business and International Division ("LB&I") announced a campaign focused on TCJA compliance issues, with a stated goal to "identify transactions, restructuring and technical issues and better understand taxpayer behavior under the new law"

- The TCJA compliance campaign builds on a prior campaign focused on the section 965 transition tax, including examinations of taxpayers filing IRS Forms 8275, *Regulation Disclosure Statement* disclosing positions taken on returns that are inconsistent with regulations issued under section 965

Tax Enforcement Update: Partnership Issues

- Many of the cross-border provisions in the TCJA, including the section 965 transition tax, the limitations on deductibility of interest under section 163(g) and the GILTI rules under section 951A have complex application in the context of partnerships

- These cross-border issues will, in large part, be examined in the context of the centralized partnership audit rules enacted in 2015 and generally effective for tax years beginning in 2018

- The cross-border provisions of the TCJA are also likely to be a focus of the IRS's recently announced Large Partnership Compliance Program, which is designed to materially increase the low rate at which large partnerships are audited and to focus those new audits on more substantive tax issues

Tax Enforcement Update: Regulatory Challenges

- The legislative environment in which the TCJA was enacted limited the opportunity for technical corrections and other legislative modifications, putting pressure on Treasury and the IRS to address errors, inconsistencies and perceived unintended results through regulatory guidance
  - Where this guidance has adopted taxpayer unfavorable positions, a growing number of taxpayers have taken (and generally disclosed on their returns) inconsistent reporting positions, signaling an intent to litigate the validity and/or application of that guidance
  - To address the risk of litigation in this area, the House-passed Build Back Better legislation includes provisions previously described as "technical corrections" to the TCJA; it remains uncertain whether those will survive if the legislation is enacted

- The IRS has indicated that it is maintaining and monitoring a list of various taxpayer challenges to the validity and or application of TCJA implementing guidance

- On December 29, 2021, the 11th Circuit issued an important decision in *Hewitt v. Commissioner*, holding that Treasury Regulations articulating technical requirements for the deductibility of certain property donations were invalid under the Administrative Procedures Act because they did not properly take public comments into account
  - Beyond its significance in pending "syndicated easement" cases, the 11th Circuit's decision (and *Oakbrook*, a similar case pending in the 6th Circuit) could have an important impact on pending challenges to TCJA regulations

Tax Enforcement Update: Pending Cases

- To date, two cases have been filed challenging regulations enacted to implement the cross-border provisions of the TCJA:
  - *Liberty Global v. United States*, Case No. 20-cv-03501 (D. Colo) (challenging the validity of temporary “extraordinary disposition” regulations that denied, in significant part, a dividend received deduction under section 245A)
    - Taxpayer’s motion for summary judgment filed October 22, 2021; government response filed on December 21, 2021)
  - *FedEx v. United States*, No. 2:20-cv-02794 (W.D. Tenn) (challenging the validity of final regulations that disallowed a foreign tax credit for amounts treated as previously taxed income for purposes of the section 965 transition tax)

- Other docketed TCJA challenges include:
  - *Moore v. United States,* No. 20-36122 (9th Cir) (challenging constitutionality of the section 965 transition tax on constitutional grounds)
  - *Silver v. United States*, Nos. 19-247 and 20-1544 (D.D.C.) (challenging transition tax and GILTI regulations on procedural grounds)
  - *Council on State Taxation v. Nebraska Dep’t. of Revenue*, No. 20-4124 (Lancaster County, NE) (challenging disallowance of state dividends received deduction for section 965 deemed repatriations)

Tax Enforcement Update: Pending Cases

- Consistent with the IRS's long-standing enforcement focus, a number of large cases are pending in the U.S. Tax Court and the courts of appeal involving "transfer pricing" adjustments under Code section 482, with the IRS taking the position that a U.S. parent company was not properly compensated (and taxed) for a foreign affiliate's use and exploitation of intangible property developed in the United States:
  - *Amgen, Inc. v. Commissioner* (Tax Court, Docket No. 16017-21)
  - *The Coca-Cola Company v. Commissioner* (Tax Court, Docket No. 31183-15)
  - *Eaton Corp. v. Commissioner* (6th Circuit, Docket No. 21-1569)
  - *Facebook, Inc. v. Commissioner* (Tax Court, Docket No. 021959-16)
  - *Medtronic, Inc. v. Commissioner* (Tax Court, Docket No. 6944-11)
  - *Western Digital Corporation v. Commissioner* (Tax Court, Docket Nos. No. 4818-19 & 18984-18)

Tax Enforcement Update: Decided Cases

- *CIC Services, LLC v. Internal Revenue Service* (Supreme Court, May 2021)
  - Holding that the federal Anti-Injunction Act does not bar a lawsuit challenging a tax information reporting requirement imposed on third parties through sub-regulatory guidance

- *Lindsay v. United States* (5th Circuit, July 2021)
  - Confirming the long-standing principle set forth in *United States v. Boyle* (Supreme Court, 1985) that taxpayers have a non-delegable duty to be aware of tax return filing deadlines and cannot obtain penalty relief by claiming they relied on their agents to monitor those deadlines

- *Taylor Lohmeyer Law Firm PLLC v. United States* (5th Circuit, 2020) (Supreme Court (denying review) October 2021)
  - Allowing the IRS to proceed with a “John Doe” summons seeking information on unknown clients of a law firm that may have received advice and assistance on tax structuring using foreign entities and financial accounts

Tax Enforcement Update:
Decided Cases

- *Fairbairn v. Fidelity Investments Charitable Gift Fund* (N.D. California February 2021) and *Pinkert v. Charles Schwab Charitable Fund* (N.D. California June 2021)
  - Dismissing lawsuits brought by taxpayers who made tax-deductible contributions to donor advised funds on the basis that they ceded all control over their donation and retained no interest in or rights with respect to donated securities

- *Whirlpool Corp. v. Commissioner* (Sixth Circuit, December 2021)
  - Holding that under the plain language of Code section 954(d)(2) (and without considering a regulation on point) income earned by Whirlpool's Luxembourg subsidiary from sales to its U.S. and Mexican subsidiaries was subject to current tax in the U.S. under the passive income provisions of Subpart F of the Code

Carried Interest Proposals

- **Current Treatment**
  - "Profits interest" not taxable on grant
  - Timing of recognition and character of share of profits determined by reference to timing of recognition and character of profits of the partnership
  - Section 1061 implemented by TCJA – 3 year hold in respect of an "applicable partnership interest" ("API")

- **Proposals**

  - *Build Back Better Act*
    - No longer in the BBA
    - Amended Section 1061
      - Holding period extended – 3 years → 5 years
        - The holding period with respect to an API does not begin to run until (1) the holder of the API acquires substantially all of its API and (2) the partnership acquires substantially all of its assets
        - Exceptions: Income threshold ($400K) and real property businesses
      - No exceptions for "qualified divided income" or Section 1231 gain
      - Gain recognized on tranfer of API notwithstanding any non-recognition provision of the Code
      - Directrs Treasury to provide regulations or other guidance to prevent abuse of Section 1061, including through distributions of property by a partnership and through carry waivers, and extend application of Section 1061 to financial instruments, contracts, or interests in entities other than partnerships

  - *Wyden Proposal*
    - Annual deferred compensation, subject to ordinary income rates and self-employment taxes
    - Annual deferred compensation amount -- Interest charge multiplied by an amount equal to (x) the holder's highest share of profits of the partnership multiplied by the invested capital of all partners minus (y) the holder's invested capital in the partnership
    - Long term capital loss equal to the deferred compensation amount

Speakers – Thank you!

[Michael Desmond](#)

Partner, Los Angeles & Washington, DC

MDesmond@gibsondunn.com

[Lorna Wilson](#)

Partner, Los Angeles

LWilson@gibsondunn.com

[Brian Hamano](#)

Senior Associate, San Francisco

BHamano@gibsondunn.com