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Budget Resolution Advanced; Infrastructure Vote Expected

The House of Representatives, August 25, voted on a budget rule related to the budget resolution passed by the Senate on August 11. The vote was strictly along party lines, 220-212, and allows progress towards a $3.5 trillion reconciliation bill that democrats hope to use to pass several provisions, including significant tax changes, that are almost exclusively supported by Democrats.

After the resolution passed the Senate earlier in the month, House leadership decided it was necessary to come back from their summer recess in advance of its planned mid-September return to take action on the resolution. At the time, it was understood that the early return would be just to vote on the budget in order to keep the reconciliation process moving forward. However, a group of ten centrist Democrats (enough to tip the scales in the budget vote) announced that they would not act on the resolution unless a vote was first held on the bipartisan Infrastructure Investment and Jobs Act.

After a few days of negotiation, Speaker Nancy Pelosi (D-Calif.) secured the support of the group by promising the House would take up the infrastructure bill by September 27.

Reconciliation Content

The demand for a reconciliation bill containing many Democratic priorities has been growing over the past few months. This growth was accelerated after President Biden agreed to remove many of the non-traditional infrastructure provisions proposed in his American Jobs Plan in negotiation the pending bipartisan package. As a result, the reconciliation bill could include many of the “human infrastructure” provisions he originally proposed, in addition to his proposals in the American Families Plan.

From a tax standpoint, many of the proposed programs would be paid for with tax increases on corporations, higher-income taxpayers, and changes to capital gains taxation. These increases would also help to extend many of the popular expansions of the child tax credit, the earned income credit, and the dependent care credit enacted for 2020 only in the American Rescue Plan Act.

Busy September

The end of September is the end of the federal government’s fiscal year, typically a busy time of year legislatively, and is exacerbated this year by a few other issues. First, a 2022 budget must be passed by October 1, or at least a continuing resolution must be passed to extend government operations. Congress must also take action on raising the debt ceiling, which GOP leadership has promised not to support. Finally, the deadline agreed to on the infrastructure bill has real-world consequences, as some transportation programs extended by the package are not funded beyond September 30.

Given the short timetable, it is unlikely that Democrats will be able to pass a budget and reconciliation bill by the end of September, especially given the hoped-for size of the bill. However, final passage of the infrastructure legislation is much more likely.

International Tax Overhaul Draft Legislation Released

Draft legislation to overhaul the international tax system was released on August 26, 2021, by three member of the Senate Finance Committee, Committee Chair Ron Wyden (D-Ore), Senator Sherrod Brown (D-Ohio), and Senator Mark Warner (D-Va). The provisions in the draft legislation build on the new international tax framework introduced by the Senators in April, 2021.

GILTI, FDII, and BEAT

The draft legislation is designed to overhaul the following three taxes added by the Tax Cuts and Jobs Act (TCJA):

- the tax on Global Intangible Low-Taxed Income (GILTI) (Code Sec. 951A);
- the tax on Foreign Derived Intangible Income (FDII) (Code Sec. 250); and
- the Base Erosion and Anti-Abuse Tax (BEAT) (Code Sec. 59A).

GILTI would be modified by applying a country-by-country system. Under the system, if a taxpayer earns income in a foreign country that is subject to an effective tax rate above the GILTI rate, the income is treated as high-tax income and is generally not treated as subject to residual U.S. Income tax (high-tax tested income). If the effective rate of tax on the income is below the GILTI rate, income is subject to a top-up tax that at least brings the total taxes on the income from that country up to the GILTI rate.

The unit of measure for determining the effective tax rate is a "tested unit", defined as a controlled foreign corporation (CFC), foreign branches owned by a CFC, and interest in certain pass-through entities owned by a CFC.

Research and development expenses and headquarters' costs would be adjusted, to prevent companies from paying higher taxes under GILTI when they invest in the United States.

In determining FDII, deemed intangible income will be replaced with domestic innovation income, which is a percentage, at a rate to be determined, of qualified research and experimentation expenses and a percentage, at a rate to be determined, of worker training expenses. The foreign derived ratio will not change. The provision is intended to end the built-in incentive to offshore factories and other assets.

The Code Sec. 250 deduction for net CFC tested income and for foreign-derived innovation income will be reduced to an amount still to be determined, increasing the GILTI and FDII rates. The deduction for GLTI and FDII will be the same.

Code Sec. 38 general business credits will be provided full value in the BEAT by not reducing regular tax liability for purposes of determining the base erosion minimum tax.

A second higher rate of tax, at a rate to be determined, will apply to base erosion income. Base erosion tax liability will be 10% × regular taxable income + TBD% × base erosion income.

Drafters of the legislation are considering how to incorporate the purposes and policies of the Stop Harmful Inversions and Ending Low-Tax Developments (SHIELD) proposal of the Biden administration.

Comments Requested

The Senators are requesting comments by September 3 on the discussion draft.

Full text of the proposal

Section-by-section summary

Final Foreign Partner Withholding Regulations To Be Deferred Until 2023

Notice 2021-51

The IRS has announced that it intends to defer until 2023 the applicability of certain final regulations under Code Sec. 1446(a) and (f) relating to withholding of tax on foreign partners' share of effectively connected income.

Withholding Provisions on Transfers of Interests in Publicly Traded Partnerships Deferred

The amendments will defer the applicability date to January 1, 2023, for certain provisions relating to (1) withholding under Code Sec. 1446(f) on transfers of interests in publicly traded partnerships ("PTP interests"); (2) withholding under Code Sec. 1446(a) on distributions made with respect to PTP interests; and (3) withholding under Code Sec. 1446(f)(4) by partnerships on distributions to transferees.

REFERENCE KEY

USTC references are to ***U.S. Tax Cases***
Dec references are to ***Tax Court Reports***

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Code Sec. 864(c)(8) generally provides that gain or loss derived by a foreign person on the sale or exchange of an interest in a partnership engaged in a U.S. trade or business is treated as effectively connected gain or loss and, therefore, is subject to U.S. tax. Code Sec. 1446(f)(1) generally requires a transferee of an interest in a partnership to withhold 10 percent of the amount realized if any portion of the gain on the disposition would be treated under Code Sec. 864(c)(8) as effectively connected with the conduct of a trade or business within the United States. Code Sec. 1446(f)(4) provides that if a transferee fails to withhold on the disposition as required under Code Sec. 1446(f)(1), the partnership must withhold on distributions to the transferee.

Taxpayers May Rely on Deferral Prior to Amendments

The final foreign partner withholding regulations were published on November 30, 2020, in T.D. 9926, I.R.B. 2020-51, 1602, and the provisions whose applicability dates the amendments will defer generally would have applied to transfers and distributions that occur on or after January 1, 2022. Taxpayers may rely on the deferrals announced in the notice prior to amendments being issued.

2022 CAP Program Application Period Opens

The IRS has announced the opening of the application period for the 2022 Compliance Assurance Process (CAP) program. The application period runs September 1 to November 1, 2021. The Service will inform applicants if they are accepted into the program in February 2022.

To be eligible to apply for CAP, new applicants must:

- have assets of $10 million or more,
- be a U.S. publicly traded corporation with a legal requirement to prepare and submit SEC Forms 10-K, 10-Q, and 8-K, and
- not be under investigation by, or in litigation with, any government agency that would limit the IRS's access to current tax records.

Taxpayers must adhere to CAP program limits on the number of open years to be eligible to participate in CAP. Further, the IRS is continuing the modification of the open-year criteria to allow-"two filed" open returns for 2022.

IR-2021-172

Fourth Quarter 2021 Interest Rates Unchanged

The over and underpayment interest rates for the fourth quarter of 2021 remain unchanged. The fourth quarter begins on October 1, 2021. The rates will be:

- 3 percent for overpayments;
- 2 percent for corporate overpayments;
- 3 percent for underpayments; and
- 5 percent for large corporate underpayments.

The interest rate for the part of a corporate overpayment exceeding $10,000 is 0.5 percent.

Computation of Fourth Quarter 2021 Interest Rates

The IRS computes these interest rates quarterly. The fourth quarter rates are based on the federal short-term rate for July 2021 which is 0 percent.

For noncorporate taxpayers:

- the overpayment rate is the short-term rate plus 3 percent; and
- the underpayment rate is the short-term rate plus 3 percent.

For corporate taxpayers:

- the underpayment rate is the short-term rate plus 3 percent;
- the overpayment rate is the federal short-term rate plus 2 percent;
- the rate on the part of a corporate overpayment that exceeds $10,000 for a tax period is the short-term rate plus 0.5; and
- the underpayment rate for large corporations is 5 percent.

Rev. Rul. 2021-17; IR-2021-173

Son of BOSS Transaction Adjustments Properly Assessed

D.B. Greenberg, CA-11, 2021-2 USTC ¶50,208

The Tax Court properly assessed adjustments of an individual involving a short option strategy (SOS), a type of Son of BOSS transaction. In this case, the SOS transaction required clients to (1) buy from a bank a foreign currency option that involved both a long and a short position; (2) transfer the long position to a partnership, which also assumed the client's obligation under the short position; and (3) withdraw from the partnership and receive a liquidating distribution of foreign currency, which the client would sell at a loss. The taxpayer, a CPA, began a partnership (P1) involved in investments.

The taxpayer on appeal (1) argued the Tax Court failed to consider its jurisdiction; (2) challenged the Tax Court's decision to uphold the adjustments the Commissioner made in five notices of deficiencies (NODs); and (3) argued the Tax Court erroneously rejected the issues he raised after trial.

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Tax Court Had Jurisdiction

The appeals court observed that the taxpayer did not call either partner of P1 to confirm his testimony concerning the signatory authorization. Nor did the taxpayer introduce any written evidence that he had such authority (powers of attorney). P1's attempted TEFRA election on its TY 1997 return was not valid. P1 was a small partnership in TY 2000 and 2001.

Because the TY 1997 election was not valid P1 was required to attach a statement signed by all of its partners in order to elect into the TEFRA procedures under Code Sec. 6231(a)(1)(B)(ii). As P1 did not do so for either TY 2000 or 2001, it was not subject to the TEFRA regime. The IRS thus was not required to send FPAAs to P1 to notify the taxpayer of adjustments to partnership items.

TY 2004 and 2009 NODs Were Timely

The Tax Court did not err in finding the TY 2004 NOD was timely mailed. The taxpayer simply asserted that there was chaos surrounding the mailing. An IRS group manager involved in the case testified that the incomplete Form 3877, Firm Mailing Book for Accountable Mail, attached to the IRS's answer was a draft placed in the taxpayer's administrative file and was not the version sent to the Post Office, as the IRS did not place a marked certified mail list in the administrative file. She also testified retrieving the completed Form 3877 with the USPS stamp from the IRS's files several weeks prior to trial.

Finally, on the TY 2009 NOD, the limitations period for making assessments against the taxpayer related to the converted items was suspended by virtue of the pendency of another case. Therefore, the TY 2009 NOD was timely as to the TY 1999.

Tax Court Had Jurisdiction Over Specific Adjustments in NODs; Did Not Abuse Discretion

The IRS was in possession of the taxpayer's tax returns before it issued the TY 2009 NODs. The adjustments were not unrelated to any deficiency for which the taxpayer was responsible. And a NOD was sufficient if it demonstrated that the Service determined a deficiency existed for a particular year and specified the amount of deficiency. Further, from the beginning the IRS sought to disallow the SOS transactions at issue in this case involving the artificial losses manufactured by the foreign currency options and their alleged sales. The options' long and short legs should have been treated as a single option spread, i.e., they could not be separated legally. As such, the Tax Court properly disallowed the losses related to those option spreads.

Finally, the Tax Court did not abuse its discretion in denying the motion to reopen the record to introduce new evidence so late into the action. The taxpayer failed to introduce documents into evidence at trial. The NOL stipulated to in the unrelated case would involve the Tax Court allowing the taxpayer to amend his petition and would require the Tax Court to decide substantive issues. These issues were well beyond just mechanical application of the settlement. The Tax Court therefore was well within its discretion to decline to entertain the NOL at such a late junction.

Affirming the Tax Court, 115 TCM 1403, Dec. 61,184(M), TC Memo 2018-74.

IRS Privately Rules on Foreign Microcaptive Arrangement

Chief Counsel Advice Memorandum 202134017

The IRS Chief Counsel ruled that an entity (taxpayer) had knowledge of purported premiums it paid to a foreign entity (F1) were not made for actual insurance. The taxpayer and F1 were owned or controlled, directly or indirectly, by the same interests, for purposes of assessing its withholding obligations. The ruling involved proposed withholding tax adjustment in an abusive foreign microcaptive case.

More than half the business of F1 was not insurance. F1 did not qualify as an insurance company under Code Secs. 831(c) and 816(a). Therefore, F1 failed to meet the requirements of Code Sec. 953(d) to be treated as a domestic corporation. The taxpayer was to be treated as having knowledge of F1 status as a foreign corporation for Code Sec. 1442 withholding purposes.

The taxpayer was liable for withholding tax of 30 percent of aggregate payments made to F1 for the tax years at issue under Code Sec. 1461. Finally, as the taxpayer failed to file a Form 1042 for multiple tax years, the IRS could assess it for its failure to withhold and deposit tax at any time under Code Sec. 6501(c)(3).

IRS Privately Rules on Trust Division and Modification

IRS Letter Ruling 202134003; IRS Letter Ruling 202134004

In each of two cases, the IRS issued rulings on income, estate, gift, and generation-skipping transfer (GST) tax consequences of a division of a trust. In the first case, the grantors established an irrevocable trust for the benefit of their children. One of the grantors transferred property to the trust, however the grantors treated the transfer as made by both, equally. The grantors each allocated the GST exemption to all of their respective portion of the transfer to the trust

on timely filed Forms 709, United States Gift (and Generation-Skipping Transfer) Tax Returns. Subsequently, the trustees of the original trust petitioned the court to approve an early division of the trust. The pro-rata transfer of assets from the original trust to the newly created trusts did not result in a sale or exchange or other disposition of any property for the purposes of Code Sec. 1001(a). Accordingly, no gain or loss would be recognized by the beneficiaries of the trusts on the division. Further, the transfer of assets was not a distribution under Code Sec. 661 and therefore was not included in the gross income of any newly created trust beneficiaries. As long as the newly created trusts created by the pro rata transfer of assets from the original trust are separately managed and administered, they would be treated as separate trusts for federal tax purposes. Additionally, since Code Sec. 1001 did not apply to the pro rata transfer of assets, under Code Sec. 1015 the basis of the newly created trust assets would be the same after the pro rata transfer of assets as the basis of those assets before the transfer. Moreover, each asset transferred by the trust to the newly created trusts would have the same holding period in the hands of the newly created trusts as it did with the original trust. Finally, the division of the original trust into the newly created trusts and the pro rata allocation of assets would not affect the status of the original trust or the newly created trusts as exempt from the GST tax.

In the second case, the trust was created under the will of the settlor. The settlor died and was survived by her spouse and children. Subsequently, the trustee of the trust filed a petition and proposed to divide the trust into two separate trusts of equal value and update the trust administrative provisions. The IRS stated that the proposed modifications would not result in a shift of any beneficial interest in the trust to any beneficiary who occupied a generation lower than the persons holding the beneficial interest. Further, the proposed modifications would not extend the time for vesting of any beneficial interest in the new trust beyond the period provided for in the trust. Accordingly, the court ordered modifications and the proposed modifications to the trust would not cause the trust or new created trusts to lose its exempt status from the GST tax or otherwise become subject to the GST tax. Additionally, the proposed division of the trusts would not cause any beneficiary of the trusts to have made a gift subject to federal gift tax. Moreover, the proposed division would not cause the assets of the trusts to be includible in the gross estate of any beneficiary of such trusts for federal estate tax purposes under Code Secs. 2035-2038. The proposed division would not cause any beneficiary of any such trust to recognize any gain or loss from a sale or other disposition of the trust assets under Code Secs. 61 and 1001. Finally, the holding period of the assets received by the new trusts would be the same as the holding period of the assets in the original trust.

Tax Court Addresses Increase in Petitions Received

Tax Court Press Release

The U.S. Tax Court announced that it received more than 26,000 petitions this year. The Tax Court met with various stakeholders, including representatives from the American Bar Association's Section of Taxation, the Internal Revenue Service, low income taxpayer clinics, and bar-sponsored pro bono programs, to address the significantly increased number of petitions received this year. While the court continues to process petitions expeditiously, it has also begun notifying the IRS of those petitions that the court received prior to service in order to limit the potential for premature assessment and enforcement action against petitioners. Additionally, the Tax Court reminded taxpayers of its dedicated email address at taxcourt.petitioner.premature.assessment@irs.gov for petitioners to reach out with concerns about premature assessments or enforcement action. Finally, petitioners can contact the Public Affairs Office at (202) 521-3355 or email publicaffairs@ustaxcourt.gov if they have questions about whether the court has received their petition.

TAX BRIEFS

Disgorgement

The government was entitled to disgorgement and its motion for default judgment was granted. An individual was found to have profited by filing tax returns that claimed false education credits. The taxpayer failed to respond to the government's motion for default judgment.

Kroll,, DC Ga., 2021-2 USTC ¶50,207

Exempt Organizations

An organization's request for tax-exempt status was denied under Code Sec. 501(c)(3). The organization was a non-profit corporation that conducted lectures, lessons, classes, and clinics in safety education. The organization did not operate exclusively for charitable, educational, and other exempt purposes because its

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activities were for the private benefit of its officers.

IRS Letter Ruling 202134018

Farm Credit System

A listing of the average annual effective interest rates on new loans under the Farm Credit System has been issued by the IRS. The rates are used in computing the special use value of farm real property for which an election is made under Code Sec. 2032A. The rates may be used by estates that value farmland under Code Sec. 2032A as of a date in 2021.

Rev. Rul. 2021-15

IRA Rollovers

An individual was granted a waiver of the 60-day rollover requirement for failure to timely recover a portion of the distribution amount which she withdrew from an individual retirement account (IRA) maintained by a financial institution. The taxpayer's failure to accomplish a timely rollover, as prescribed under Code Sec. 408(d)(3), was due to the fact that she relied on a chief financial officer who failed to ensure that the shares of stock were received by the financial institution for deposit into IRA within the rollover period.

IRS Letter Ruling 202134019

Liquidations

The IRS privately ruled on the tax consequences of a proposed transaction. The authority was a political subdivision of the state and was created pursuant to an Act and was governed by a board of trustees. The authority provided a business with services in a service area through its wholly owned subsidiary. It was later determined that the business could be conducted more efficiently if the subsidiary was eliminated as a separately controlled corporation and that merging the subsidiary and the authority was consistent with the objectives of the Act. The IRS stated that the other transactions would not preclude the proposed transaction from otherwise qualifying as a liquidation under Code Sec. 332. Further the regulations issued under Code Sec. 337(d) did not apply to the liquidation of the subsidiary. The subsidiary was a tax-exempt entity. The combination of the subsidiary and the authority and the distribution of the subsidiary's assets to the authority would be a transfer of assets from a tax-exempt entity to a political subdivision. Accordingly, such transactions were not covered by the regulations under Code Sec. 337(d).

IRS Letter Ruling 202134013

Penalties

The IRS Chief Counsel issued an advice on what constitutes a false or fraudulent statement for purposes of assessing a Code Sec. 6700 penalty against a promoter. The Chief Counsel held that there are two types of statements that fall within the statutory bar of Code Sec. 6700(a)(2)(A): (1) statements directly addressing the availability of tax benefits; and (2) those concerning factual matters that are relevant to the availability of the tax benefits. Further, statements in the context of micro-captive insurance transactions include opinions, promotional materials, reports, tax savings projections, or other statements (or materials relied upon in making such statements) that are false or fraudulent as to any matter material to exclusion of income under Code Sec. 831(b) or tax deductions under Code Sec. 162 for premiums paid by the insured.

Chief Counsel Advice Memorandum 202134016

Per Diem Rates

The U.S. State Department has released a listing of maximum travel *per diem* allowances for travel in foreign areas. The rates apply to all government employees and contractors, and are effective as of September 1, 2021.

September Maximum Travel Per Diem Allowances for Foreign Areas

Premium Assistance Credit

The IRS has updated the applicable percentage table used to calculate an individual's premium tax credit and required contribution percentage plan years beginning in calendar year 2022. The percentage is used to determine whether an individual is eligible for affordable employer-sponsored minimum essential coverage; the percentage is used to determine whether an individual is eligible for an exemption from the individual shared responsibility payment because of a lack of affordable minimum essential coverage. For plan years beginning in 2022, the required contribution percentage under Code Sec. 36B is 9.61 percent. Further, the IRS and the Treasury department have determined that the failsafe exception described in Code Sec. 36B(b)(3)(A)(ii)(III) applies for calendar year 2022 and no additional adjustment under Code Sec. 36B(b)(3)(A)(ii)(II) is required for calendar year 2022. The guidance is effective for tax years and plan years beginning in calendar year 2022.

Rev. Proc. 2021-36

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