Quarterly tax developments

Things to know about this quarter’s tax developments and related US GAAP accounting implications

Updated through 31 December 2019
Tax developments

Legislation enacted in the fourth quarter

Companies are required to account for the effects of changes in tax laws in the period the legislation is enacted. These changes are included in a company’s estimate of its annual effective tax rate in the first interim period that includes the effective date of the rate change, but not earlier than the period that includes the enactment date. If an interim change is significant, temporary differences may need to be estimated as of the enactment date.

Federal, state and territories

Federal – On 20 December 2019, President Trump signed into law the Taxpayer Certainty and Disaster Tax Relief Act of 2019, which extended the controlled foreign corporation (CFC) look-through rule, the work opportunity tax credit and the new market tax credit for one year, through 2020. The Act also extends biodiesel incentives through 2022. See Americas Tax Policy: This Week in Tax Policy News for 20 December 2019.

North Carolina – On 1 November 2019, North Carolina enacted legislation requiring companies to deduct certain economic incentive awards from their state income tax base, effectively making the awards nontaxable. This change is retroactively effective for tax years beginning on or after 1 January 2019 and applies to awards received on or after that date. See the State and Local Tax Weekly for 15 November 2019.

On 8 November 2019, North Carolina enacted legislation adopting market-based sourcing rules for apportioning all income earned by multistate businesses, including income from sales of services and intangible property. Special rules apply to financial institutions, electric power companies and certain distributors. The changes apply to tax years beginning on or after 1 January 2020. See Tax Alert 2019-2113, dated 2 December 2019.

Utah – On 18 December 2019, Utah enacted legislation reducing its corporate income tax rate to 4.66% from 4.95%. The change is effective for tax years beginning on or after 1 January 2020. See Tax Alert 2020-0044, dated 9 January 2020.

International

Argentina – On 23 December 2019, Argentina enacted legislation postponing for one year a scheduled decrease in the corporate income tax rate. For tax years beginning 1 January 2020, the corporate rate will remain 30%, instead of decreasing to 25% as scheduled under an earlier law.

The legislation also postpones for one year a scheduled increase in the dividend withholding tax rate. For tax years beginning 1 January 2020, the dividend withholding tax rate will remain 7%, rather than increasing to 13% rate as scheduled under an earlier law.

Other changes include:

- Requiring companies to allocate deductions for 2019 and 2020 inflation adjustments over six years
- Permitting companies to deduct 100% of inflation adjustments in the year the adjustment is calculated, beginning 1 January 2021

Colombia – On 27 December 2019, Colombia enacted tax reform legislation to replace its 2018 tax reform law, which the Colombian Constitutional Court declared unconstitutional due to procedural flaws. (See the “Other considerations” section of this publication for a discussion of the Court’s decision). The new law includes the following changes:

- Reducing the 33% corporate income tax rate to 32% for 2020, 31% for 2021 and 30% for 2022 and subsequent years
- Changing the thin capitalization rules so they apply only to related party debt and limiting interest expense deductibility under those rules to loans that exceed a company’s 2:1 (rather than 3:1) debt-to-equity ratio
- Establishing a 9% corporate income tax rate for income from certain activities (e.g., hospitality services in new or refurbished hotels) for 10 to 20 years, depending on the activity
- Reducing the 3.5% presumptive income tax (i.e., an alternative income tax based on a percentage of net equity from the prior year) to 1.5% for 2019, 0.5% for 2020 and 0% for 2021 onward
- Increasing the dividend withholding tax rate for foreign investors to 10% from 7.5%
- Imposing a 4% surtax on certain financial institutions for 2020 and a 3% surtax for 2021 and 2022
- Allowing companies to claim 50% of certain non-income taxes as a credit against their income tax liability
- Subjecting a permanent establishment (PE) to tax on its worldwide source income and limiting deductions for interest expenses that are attributable to a PE and not subject to withholding tax
- Limiting application of the CFC regime
- Clarifying the requirements for claiming a tax exemption for income from entrepreneurial and technological activities

The changes are generally effective 1 January 2020. See Tax Alert 2020-0025, dated 6 January 2020.

Ecuador – On 30 December 2019, Ecuador enacted legislation repealing the tax exemption for dividends, except for dividends paid to other Ecuadorian entities. The legislation also repeals the tax exemption for gains derived from the sale of real estate. Other changes include:

- Modifying the thin capitalization rules
- Allowing deductions for lease payments if the lease is not part of a “back-to-back” transaction
- Eliminating deductions for related party indirect expense allocations (currently deductible with a 5% cap)
- Repealing the cap on deductions for promotional and advertising costs and expenses
- Applying transfer pricing rules, regardless of whether other regimes and principles apply (e.g., economic substance, general or specific anti-avoidance rules)
- Establishing a voluntary disclosure regime for (1) Ecuadorian tax residents that, as of 31 December 2018, had earned income or carried out operations subject to income tax; and (2) taxpayers that, as of 31 December 2018, maintained assets abroad that were not reported on their income tax returns
- Imposing a 10% withholding tax (tax base of 40% taxed at a 25% rate) on dividends paid to nonresidents, which could be reduced if applicable tax treaty requirements are met
- Imposing a temporary tax ranging from 0.10% to 0.20% on companies with revenues of $1 million or more in tax year 2018 and allowing them to pay the tax from 2020 through 2022

The changes are effective 1 January 2020.

* A Tax Alert has not been published on this development.
■ Designates a new development.
France* – On 29 December 2019, France enacted legislation modifying previously enacted decreases in its corporate income tax rates. For tax years beginning on or after 1 January 2020, the corporate income tax rate is 28% on the first €500,000 of taxable income, rather than all income, and only applies for large companies (or tax consolidated groups) with revenue realized in France equal to, or higher than, €250 million. The 33% corporate income tax rate on taxable income over €500,000 decreases to 31% instead of 28%, as previously scheduled, and only applies to these large companies (or tax consolidated groups).

For tax years beginning on or after 1 January 2021, the corporate rate for these large companies decreases to 27.5% for all income, instead of 26.5%, as previously scheduled. For tax years beginning on or after 1 January 2022, a 25% rate for all income applies as previously scheduled.

Other changes include:

► Implementing the anti-hybrid rules of the European Union (EU) in Anti-Tax Avoidance Directive (ATAD) 1 and ATAD 2
► Repealing domestic anti-hybrid rules for interest expenses, which were replaced with the implementation of the EU’s anti-hybrid rules
► Tightening the requirements for claiming the research and development (R&D) tax credit
► Allowing foreign companies in a tax loss position to claim a refund of certain withholding taxes, provided various requirements are satisfied
► Allowing nonresident companies holding a French branch to avoid or limit the imposition of French branch tax if they can demonstrate that their profits have not been diverted out of France

The changes are effective 1 January 2020.

Germany* – On 17 December 2019, Germany enacted legislation limiting the 95% trade tax exemption for dividends received from a non-EU company to shareholders that own at least 15% (rather than the current 10%) of a company. Other changes include:

► Eliminating the activity test that distributing non-EU companies must currently pass for German shareholders to claim the 95% trade tax exemption
► Using income tax incentives to encourage investment in the development of electric and hybrid cars

The changes are effective 1 January 2020.

On 20 December 2019, Germany* enacted legislation allowing companies to claim income tax credits for expenses from research conducted in Germany, if certain requirements are met. The change is effective 1 January 2020.

India – On 11 December 2019, India reduced its base corporate tax rate to 22% from 25%/30% for Indian companies that meet certain conditions. It also introduced a 15% base for newly formed manufacturing companies (subject to certain specified conditions). Other changes include:

► Withdrawing the share buyback tax for listed Indian companies that publicly announced share buybacks before or on 5 July 2019, but had not completed the buyback by that date
► Repealing, for foreign portfolio companies, the surcharge on capital gains from the transfer of securities

The changes are effective for tax years beginning 1 April 2019. See Tax Alert 2019-2250, dated 19 December 2019.

* A Tax Alert has not been published on this development.
■ Designates a new development.
Ireland – On 22 December 2019, Ireland enacted legislation adopting the 2017 transfer pricing guidelines of the Organisation for Economic Co-operation and Development (OECD) and the EU’s ATAD 2. The transfer pricing rules apply to non-trading transactions and certain capital transactions but not to some domestic transactions. The Anti-hybrid rules apply to payments made on or after 1 January 2020 and include capital payments (e.g., payments to acquire assets qualifying for capital allowances).

Other changes include:

- Increasing the dividend withholding tax rate to 25% from 20%
- Disallowing a corporate income tax deduction for “taxes on income,” such as dividend withholding taxes and royalty withholding taxes

The changes are effective 1 January 2020.

Italy – On 30 December 2019, Italy enacted legislation replacing the reduced corporate income tax rate on “qualifying taxable income” with a notional interest deduction (NID) regime, which was in force until 2018 and repealed as of 2019. Under the NID regime, companies may deduct 1.3% of their qualifying equity and may carry forward and use any excess NIDs. The change retroactively applies from 2019 onward. Other changes include:

- Replacing the extra-amortization regime for certain high-tech investments with a new tax credit for the purchase of new tangible assets (including the ones previously covered by extra amortization) and certain intangible assets
- Broadening eligibility for the R&D credit
- Allowing certain nonresident companies to elect to increase their stock basis in private companies held as of 1 January 2020 by paying an 11% substitute tax
- Allowing companies to deduct 50% of their municipal property tax on certain real property assets (i.e., not trade assets) for corporate income tax purposes in 2020

Unless otherwise indicated, the changes are effective 1 January 2020. See Tax Alert 2020-XXX, dated Y January 2020.

Kenya – On 7 November 2019, Kenya enacted legislation taxing income earned in the “digital marketplace” (i.e., an electronic platform through which buyers and sellers of goods and services directly interact). The legislation also taxes the income of a nonresident shipping line, as well as certain payments from a foreign corporation’s Kenyan PE to the foreign corporation.

Other changes include:

- Exempting foreign investments in affordable housing projects from Kenya’s thin capitalization rules
- Exempting investee companies of a real estate investment trust (REIT) from income tax except for certain withholding tax payments on interest income and dividends
- Reducing the corporate income tax rate to 15% from 30% for five years for companies operating a plastics recycling plant
- Exempting corporate reorganizations from capital gains tax, provided certain requirements are met

The changes have various effective dates. See Tax Alert 2019-2045, dated 15 November 2019.
Mexico – On 9 December 2019, Mexico enacted tax reform legislation for 2020 designed to align Mexican tax law with certain recommendations of the OECD for preventing base erosion and profit-shifting. The changes include:

- Adopting a general anti-avoidance rule that would allow tax authorities to recharacterize transactions that lack business purpose
- Limiting deductions for payments made directly or indirectly to related parties resident in jurisdictions with an income tax rate lower than 22.5%
- Adopting anti-hybrid rules and treating transparent entities as corporations for Mexican income tax purposes
- Limiting interest expense deductions to 30% of "adjusted taxable income" (similar to earnings before interest, taxes, depreciation and amortization) for companies with more than MxP20 million of annual net interest
- Expanding Mexico’s PE definition


Netherlands – On 16 December 2019, the Netherlands enacted legislation repealing a decree that provided a favorable application of the hybrid-entity provision in the Netherlands’ income tax treaty with the US. Without the decree, dividend distributions by a Dutch resident entity to a reversed hybrid entity, often a CV (a type of Dutch partnership) or a limited partnership, could be subject to the hybrid-entity rule and thus subject to a 15% Dutch dividend withholding tax. The change is effective 1 January 2020.

On 27 December 2019, the Netherlands enacted legislation reducing the top corporate income tax rate to 21.7%, beginning in 2021. The rate on the first €200,000 will drop to 16.5% in 2020 and to 15% in 2021. Other changes include:

- Aligning the Dutch definitions of PE and personal representative with the definitions used in Dutch income tax treaties or the OECD’s Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, if no treaty applies, beginning in 2020
- Limiting interest expense deductions for certain banks and insurance companies, beginning in 2020
- Implementing the EU’s ATAD on hybrid mismatches, which may limit cost deductions or result in the inclusion of income for tax years beginning on or after 1 January 2020
- Imposing a 21.7% withholding tax on interest and royalties paid to companies located in certain low-tax jurisdictions, beginning in 2021
- Imposing a 21.7% withholding tax on interest and royalties paid under an abusive arrangement, beginning in 2021
- Amending anti-abuse rules for the Dutch dividend withholding tax exemption so that satisfying an existing safe harbor alone may not prevent application of the 15% Dutch dividend withholding tax, beginning in 2020

On 30 December 2019, the Netherlands enacted legislation updating its list of low-tax jurisdictions (i.e., countries with a statutory corporate income tax rate of less than 9%) to remove Belize, Kuwait, Qatar and Saudi Arabia and to add Barbados and Turkmenistan. The updated list, which is effective 1 January 2020, is relevant for applying the CFC rules and will be relevant for applying withholding tax to interest and royalty payments made to related companies, beginning 1 January 2021.

* A Tax Alert has not been published on this development.
■ Designates a new development.
**Norway** – On December 2019, Norway enacted legislation amending its interest cap rules to clarify, among other things, which entities are in the rules’ scope and to provide special rules for companies that have been part of a merger during the tax year. The changes are retroactively effective for the 2019 tax year onward. Among other things, the legislation also limits deductions under the research and development tax incentive regime. Those changes are effective for the 2020 tax year onward.

**South Korea** – On 31 December 2019, South Korea enacted legislation taxing royalties received for patents that are registered outside the country and used in domestic manufacturing. Similarly, compensation paid by a South Korean company for infringing on a patent registered outside the country is subject to a 16.5% withholding tax, which includes the 10% surtax.

Other changes include:

- Taxing capital gains realized by nonresidents on the sale of their shares in a South Korean real property holding company
- Placing the burden of proof on taxpayers to demonstrate that certain transactions have a valid business purpose and were not intended to avoid tax

The changes are effective 1 January 2020.

**Thailand** – On 1 November 2019, Thailand repealed, via royal decrees, tax incentives under the Regional Operating Headquarters (ROH) I and II, International Headquarters (IHQ) and International Trading Center (ITC) regimes. A single tax incentive regime, the existing International Business Center regime, replaced these regimes.

With the repeal, benefits under these regimes are no longer available as of the following dates:

- 1 January 2021 for reduced corporate income tax (CIT) rates and exemptions for qualifying income under the ROH I regime
- 1 June 2019 for reduced CIT rates and exemptions under the ROH II, IHQ and ITC regimes
- 1 January 2021 for withholding tax exemptions for qualifying dividends distributed to nonresident shareholders under the ROH II, IHQ and ITC regimes


**United Kingdom** – On 5 November 2019, the United Kingdom enacted changes to the rules governing the imposition of a 20% tax on income that certain foreign companies derive by using intangible property to generate UK sales of goods and services. The changes include:

- Extending the application of the tax to income of foreign companies that reside in a jurisdiction with which the UK has an income tax treaty but are excluded from the treaty's terms (e.g., a Barbados International Business Company)
- Narrowing the definition of residence to exclude companies that are liable for tax only on income received from sources within a jurisdiction
- Broadening the definition of UK sales to include companies that acquire and resell objects without changing them
- Exempting companies located in certain jurisdictions from paying the tax

The changes have varying effective dates.

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* A Tax Alert has not been published on this development.
■ Designates a new development.
▲ Not previously included.
Treaty changes

Tax treaties are agreements between countries that typically address withholding tax rates or exemptions on dividends, interest and royalties paid in multiple jurisdictions. Exceptions may apply based on the tax treaty (for instance, reduced rates may apply to certain categories of investors, capital gains from immovable property or property-rich companies may be taxable). All of the following tax treaty changes were effective in the fourth calendar quarter.

<table>
<thead>
<tr>
<th>Countries involved</th>
<th>Summary of changes</th>
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<tbody>
<tr>
<td>Japan United States</td>
<td>Provides general withholding tax rates of 10% on dividends and 0% on interest and royalties; exempts capital gains from tax.</td>
</tr>
<tr>
<td>Spain United States</td>
<td>Provides general withholding tax rates of 15% on dividends and 0% on interest and royalties; exempts capital gains from tax.</td>
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Other considerations

**Federal, state and territories**

**Federal** — The Government finalized regulations on the base erosion anti-abuse tax (BEAT) and the foreign tax credit (FTC) modifications under the Tax Cuts and Jobs Act (TCJA). The final regulations are generally consistent with the proposed regulations published in 2018 but make certain modifications. See Tax Alert 2019-2154, dated 6 December 2019, and Tax Alert 2019-2155, dated 8 December 2019. For a discussion of related developments, see the “Things we have our eyes on” section of this publication.

In final regulations, the Government eliminated the minimum documentation requirements that must be satisfied to treat certain financial arrangements among related parties as debt for federal income tax purposes. See Tax Alert 2019-1962, dated 4 November 2019.

The Government finalized, without changes, proposed regulations under IRC Sections 954 and 958 affecting taxpayers’ computation of Subpart F income and global intangible low-taxed income (GILTI). The final regulations modify the active marketing exception to the definition of foreign personal holding company income and the rules for classifying a person as related to a CFC. See Tax Release 2019-2055, dated 18 November 2019.

In a revenue ruling, the Government ruled that a hard fork (e.g., when one cryptocurrency becomes two) will not cause taxpayers to recognize income. Taxpayers will recognize ordinary income, however, if they receive new units of cryptocurrency following the hard fork. See Tax Alert 2019-1871, dated 21 October 2019.

In a set of frequently asked questions on the IRS website, the Government expanded on its 2014 cryptocurrency guidance by providing more examples of (1) when taxpayers recognize gain or loss on an exchange of cryptocurrency, (2) how to calculate the tax basis in cryptocurrency and (3) when taxpayers recognize income on other cryptocurrency-related transactions. See Tax Alert 2019-1871, dated 21 October 2019.

In a notice, the Government announced that companies may continue relying on the October 2016 proposed regulations on characterizing certain corporate interests as stock or debt under IRC Section 385, even though the related temporary regulations expired on 13 October 2019. See Tax Alert 2019-1836, dated 16 October 2019.

In a revenue procedure, the Government updated its automatic accounting method change procedures for leasing transactions. Under the updated procedures, companies may make an automatic accounting method change, with an IRC Section 481 adjustment, for leasing transactions entered before the beginning of the year of change. Similarly, taxpayers may also make an automatic accounting method change, with an IRC Section 481 adjustment, for an existing lease. In both cases, companies must satisfy certain administrative requirements to obtain the change. See Tax Alert 2019-2059, dated 18 November 2019.

The US Tax Court held that the target in an acquisition could not deduct a finder’s fee that it paid to a service provider that was engaged by an institutional investor affiliated with the acquirer. The Court noted that the target failed to establish a direct link between the benefits it derived from the transaction and the payment. See Tax Alert 2019-1936, dated 31 October 2019.

**Massachusetts** — In final regulations, the Government asserted that out-of-state businesses are subject to tax on income earned in Massachusetts if their Massachusetts sales exceed $500,000.

The Massachusetts Appellate Tax Board held that an in-state manufacturer must source litigation awards, settlement payments and authorization royalties from patent litigation entirely to Massachusetts for corporate excise tax purposes, even though the case was litigated in another state and out-of-state companies paid part of the award. See the State and Local Tax Weekly for 15 November 2019.

* A Tax Alert was not published on this development.
**New Jersey** – The Government issued guidance defining “unitary business” for purposes of filing a combined return under New Jersey's corporation business tax rules and outlined the criteria for determining whether a unitary business exists. See the [State and Local Tax Weekly for 25 October 2019](#).

The Government also released guidance on how to apply New Jersey's new net operating loss (NOL) carryforward rules.

**New York** – The Government explained how to compute the adjusted basis in New York property for purposes of qualifying for the tax incentive for New York manufacturers. See the [State and Local Tax Weekly for 25 October 2019](#).

**Pennsylvania** – The Commonwealth Court held that two multistate companies were entitled to full refunds of income taxes paid in 2001 and 2006, even though the case on which the refunds were based was decided in 2017. The 2017 case on which the companies based their refund claims held that Pennsylvania’s dollar cap on NOL deductions violated the uniformity clause of the state constitution. See [Tax Alert 2019-2112, dated 2 December 2019](#).

**State** – The following states released TCJA guidance for state corporate income tax purposes:

- Indiana* (bonus depreciation and IRC Section 179 depreciation)
- Iowa (GILTI and foreign derived intangible income (FDII))
- Louisiana* (GILTI)
- Massachusetts* (IRC Section 163(j) interest expense limitation)
- Montana (IRC Section 965 repatriation, GILTI and FDII)
- Nebraska (GILTI, FDII)
- New Jersey* (GILTI, FDII)
- Virginia (IRC Section 163(j) interest expense limitation)


**Wisconsin** – The state Court of Appeals upheld a determination by the Tax Appeals Commission that an out-of-state company did not owe Wisconsin franchise tax on royalties that it received for licensing computer software to out-of-state computer manufacturers, even though the manufacturers sold their product packaged with a license to the software to end-users in Wisconsin. The Court rejected the state’s argument that the royalties should be sourced to Wisconsin due to the software end-users being qualified as “licensors” under state law. See [Tax Alert 2019-1986, dated 7 November 2019](#).

**International**

**Argentina** – In regulations, the Government outlined the requirements companies must satisfy to obtain certain income tax benefits under the promotional regime for the knowledge-based economy (e.g., software development and related activities, biotechnology, artificial intelligence, robotics). The benefits include a 15% income tax rate for companies engaged in eligible activities in Argentina. See [Tax Alert 2019-1867, dated 21 October 2019](#).

**Colombia** – The Constitutional Court declared the 2018 tax reform law unconstitutional because of procedural flaws in the Colombian Congress’s approval process. The law will remain effective until the end of 2019. If Congress does not approve a new tax reform law by 31 December 2019, the tax regime in force before the 2018 tax reform will apply beginning 1 January 2020. See [Tax Alert 2019-1843, dated 17 October 2019](#). For a related development, see the “Things we have our eyes on section” of this publication.

* A Tax Alert was not published on this development.
Paraguay – In a decree, the Government outlined the effective dates, for calendar-year taxpayers, of tax reform legislation enacted in Paraguay on 25 September 2019.

The following provisions are effective 1 January 2019:

- Deductions for certain expenses
- The elimination of the last-in, first-out valuation method for tax purposes
- A five-year carryforward for losses equal to or less than 20% of net income for each future tax period

The following provisions are effective 1 January 2020:

- A 10% business income tax will apply to Paraguayan companies’ service and investment income (the tax replaces the income tax on commercial, industrial and service activities and the income tax on agricultural activities and will apply under two regimes (general and simplified))
- An 8% tax on dividends and earnings for local taxpayers and 15% for nonresidents
- A 15% tax on nonresident income from services or investments

Effective 1 January 2021, new transfer pricing rules apply based on OECD standards.


Peru – In an urgent decree, the Government extended the capital gains tax exemption for certain stock transfers to 31 December 2022 from 31 December 2019. See Tax Alert 2019-1931, dated 30 October 2019

In another urgent decree, the Government extended the tax regime for real estate investment trusts (REITs) to 31 December 2022 from 31 December 2019. Under the regime, tax is deferred on transfers of real property to REITs, and capital gains from REIT certificates traded on the Lima Stock Exchange are exempt from income tax. See Tax Alert 2019-1940, dated 1 November 2019.

Spain – The Supreme Court held that a US mutual fund was entitled to a refund of the difference between the dividend withholding tax it paid in 2009 and the tax due under the reduced 1% corporate income tax rate for Spanish Collective Investment Vehicles (CIVs). The Court reasoned that limiting the 1% rate to only Spanish CIVs violated EU law. See Tax Alert 2019-2096, dated 26 November 2019.

The Central Tax Court held that Spain’s withholding tax exemption did not apply to interest payments made by a Spanish debtor to its Dutch shareholder. The Court reasoned that the shareholder was not the beneficial owner of the payments, even though Spanish withholding tax rules do not require the payment recipient to be a beneficial owner. See Tax Alert 2019-2098, dated 26 November 2019.

Taiwan – In regulations, the Government clarified the types of expenses for which companies may claim tax credits for investing in smart machines and fifth-generation mobile networks. See Tax Alert 2019-1970, dated 5 November 2019.
Things we have our eyes on

Federal, state and territories

Foreign tax credits — The Government proposed additional foreign tax credit regulations on allocating and apportioning expenses. The new proposed regulations also address allocating and apportioning foreign taxes to separate IRC Section 904(d) categories of income. See Tax Alert 2019-2155, dated 8 December 2019. For a discussion of a related development, see the “Other considerations” section of this publication.

BEAT — The Government proposed additional new BEAT regulations on which companies may rely for tax years beginning after 31 December 2017. See Tax Alert 2019-2154, dated 6 December 2019. For a discussion of a related development, see the “Other considerations” section of this publication.

Delaying applicability of foreign currency regulations — The Government announced that it will again delay the effective date of temporary and final regulations under Section 987 for an additional year. The regulations, which will take effect 1 January 2021 for calendar-year taxpayers, address income and currency gains or losses with respect to a qualifying business unit, as well as the recognition and deferral of foreign currency gains or losses. See Tax Alert 2019-2179, dated 11 December 2019.

Interest rates — The Government proposed regulations addressing the tax consequences of the phase out of the London interbank offered rate (LIBOR) and other interbank offered rates and the transition to other reference rates in debt instruments and other contracts. See Tax Alert 2019-1804, dated 10 October 2019.

Section 385 distribution regulations — In an advance notice of proposed rulemaking, the Government announced that it may modify the so-called distribution regulations under Section 385, which treat certain issuances of a debt instrument in a distribution (or similar transaction) as an issuance of stock. Modifications under consideration include replacing the per-se funding rule, which generally recharacterizes debt as stock if it is issued 36 months before or 36 months after certain transactions, with a facts and circumstances test. See Tax Alert 2019-1962, dated 4 November 2019.

Opportunity Zones — A bill was introduced in Congress that would substantially change the requirements for Qualified Opportunity Zones by increasing reporting and immediately eliminating designated Opportunity Zones that are not low-income. The bill would also clarify investment rules, disallow additional types of properties and business, and require review by the Government Accountability Office. See Tax Alert 2019-2017, dated 12 November 2019.

Energy incentives — The House Ways and Means Subcommittee on Select Revenue Measures released a discussion draft that proposes to retroactively extend many expired energy tax incentives through 2024 and increase the cap for the electric vehicle (EV) credit. See Tax Alert 2019-2069, dated 20 November 2019.

Executive compensation — The Government proposed regulations that would significantly expand the scope of IRC Section 162(m) such that the limit on executive compensation deductions would apply to more taxpayers and types of compensation (e.g., compensation paid by partnerships with corporate partners). Certain provisions of the regulations are proposed to apply retroactively. See Tax Alert 2019-2229, dated 17 December 2019.

International

Chile — The Government proposed imposing a 35% tax on dividends distributed to foreign investors resident in a tax treaty jurisdiction. A 44.45% tax would apply to dividends distributed to foreign investors in non-tax treaty jurisdictions. Other proposals include:

- Temporarily allowing companies to claim 50% bonus depreciation for the value of fixed assets placed in service before December 2021 for new investment projects
- Gradually prohibiting Chilean holding companies in a tax loss position from claiming a refund of the corporate taxes paid by local subsidiaries remitting dividends

Denmark – The Government proposed implementing CFC rules from the EU’s Anti-Tax Avoidance Directive. The Government also proposed aligning Denmark’s PE definition with the latest OECD definition but leaving certain Danish rules in place. Other proposals include allowing Danish companies to deduct losses incurred by their foreign subsidiaries or PEs or losses incurred on real estate. See Tax Alert 2019-1977, dated 6 November 2019.

Malaysia – The Government proposed an income tax exemption for (1) qualifying income from the development of patents and copyright software and (2) electrical and electronic companies investing in certain services. Both exemptions would apply for up to 10 years.

Other proposals include:

- Allowing manufacturers to claim accelerated depreciation on the first RM2 million–RM4 million spent on qualifying automation equipment for three additional years, to tax year 2023, and allowing service companies to claim the incentive in certain cases
- Allowing manufacturers to also claim an income exemption equal to the first RM 2 million–RM4 million spent on qualifying automation equipment against 70% of their qualifying income for three additional years, to tax year 2023, and allowing service companies to claim the exemption in certain cases
- Decreasing the temporary income tax exemption for income from qualifying green service activities to 70% from 100% and extending it an additional three years, to tax year 2023


OECD – In a public consultation document, the OECD proposed basing nexus for income tax purposes largely on a company’s sales within a country, rather than physical presence. This new definition of nexus would be separate from existing PE rules, which would continue to exist.

In the same document, the OECD also proposed new and revised rules for allocating profits. Under these rules, the formula for allocating profits would depend on a company’s level and type of activity in a jurisdiction, even if the company has no physical presence in that jurisdiction. See Tax Alert 2019-1809, dated 11 October 2019.

In a separate public consultation document, the OECD requested comments on possible approaches to determining tax basis and effective tax rates under proposed global minimum tax rules. It also requested comments on possible approaches to limiting the rules’ application. See Tax Alerts 2019-2009, dated 8 November 2019, and 2019-2042, dated 15 November 2019.

Appendix

FASB issues guidance that simplifies the accounting for income taxes

What you need to know

- The FASB issued final guidance that simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition of deferred tax liabilities for outside basis differences.

- The new guidance also simplifies aspects of the accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill.

- It clarifies that single-member limited liability companies and similar disregarded entities that are not subject to income tax are not required to recognize an allocation of consolidated income tax expense in their separate financial statements, but they could elect to do so.

- The guidance is effective for calendar-year public business entities in 2021 and interim periods within that year. For all other calendar-year entities, it is effective for annual periods beginning in 2022 and interim periods in 2023. Early adoption is permitted.

Overview

The Financial Accounting Standards Board (FASB or Board) issued final guidance\(^1\) that simplifies the accounting for income taxes by eliminating some exceptions to the general approach in Accounting Standards Codification (ASC) 740, Income Taxes. It also clarifies certain aspects of the existing guidance to promote more consistent application, among other things.

The new guidance is part of the FASB’s broader simplification initiative that is aimed at reducing the cost and complexity of applying accounting standards. Stakeholders had recommended that the FASB make these changes to the guidance.

Key considerations

Exceptions the new guidance eliminates

The new guidance eliminates the following exceptions to the general approach in ASC 740:

Exception to the general intraperiod tax allocation principle

The amendments eliminate the legacy exception to the general guidance in ASC 740-20 on how to allocate income tax expense or benefit for the year to continuing operations, discontinued operations, other comprehensive income, and other charges or credits recorded directly to shareholders’ equity. As a result, entities that have been subject to the exception may see a change in the amount of income tax benefit they allocate to continuing operations.

The general guidance requires entities to first determine the tax effect of their pretax income from continuing operations without regard to the tax effect of the other items. However, the legacy exception in ASC 740-20-45-7 requires that, when an entity has a loss from continuing operations, all items (i.e., discontinued operations, other comprehensive income and so forth) be considered in determining the amount of the tax benefit from the loss from continuing operations that is allocated to continuing operations.

Stakeholders said this exception is difficult to apply and doesn’t benefit users of the financial statements because the outcome is often counterintuitive. That is, a tax benefit may be allocated to continuing operations and an offsetting tax expense may be allocated to another item, even though total tax expense in the period is zero. Stakeholders also noted that there is diversity in practice in how the exception is applied.

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\(^1\) Accounting Standards Update (ASU) 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes.
The following illustration provides an example of the allocation of income tax expense after an entity adopts the guidance that eliminates the exception.

**Illustration – Allocation of income tax expense after adoption of ASU 2019-12**

**Facts**

Company A has a pretax loss from continuing operations of $10,000 and pretax income from discontinued operations of $12,000 for the year. Company A’s income tax rate is 25%.

This example assumes that there are no temporary differences (i.e., the company’s pretax financial income equals its taxable income) for simplicity. This example also assumes that the company would not be able to realize the benefit of the net operating loss (NOL) carryforward from the loss in continuing operations (i.e., would need a full valuation allowance) if it can’t consider the income from discontinued operations.

The calculation of the total income tax expense would be the same under the legacy and new guidance and is shown below.

**Calculation of the total income tax expense**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pretax loss from continuing operations</td>
<td>$ (10,000)</td>
</tr>
<tr>
<td>Pretax income from discontinued operations</td>
<td>$ 12,000</td>
</tr>
<tr>
<td>Pretax income</td>
<td>$ 2,000</td>
</tr>
<tr>
<td>Income tax rate</td>
<td>25%</td>
</tr>
<tr>
<td>Total income tax expense</td>
<td>$ 500</td>
</tr>
</tbody>
</table>

**Analysis under the new guidance**

Company A will no longer be able to consider the pretax income recorded in other categories when it determines the tax benefit to allocate to continuing operations. Company A’s total income tax expense is allocated between the loss from continuing operations and income from discontinued operations as follows:

<table>
<thead>
<tr>
<th>Allocate income tax expense to continuing operations and other items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax benefit allocated to continuing operations (income from discontinued operations is not considered in determining the amount allocated)</td>
</tr>
<tr>
<td>Income tax expense allocated to discontinued operations (total income tax expense less amount allocated to continuing operations or $500 - $0 = $500)</td>
</tr>
<tr>
<td>Total income tax expense</td>
</tr>
</tbody>
</table>

Because Company A cannot consider income from other categories and would be unable to realize the benefit of the NOL carryforward without considering the income from discontinued operations, it cannot allocate any tax benefit to continuing operations. Instead, the entire amount of the total income tax expense is allocated to discontinued operations.

**Analysis under the legacy guidance**

Because there is a loss from continuing operations and income from other items, the exception to the general principle of allocating income tax expense to continuing operations applies, and the $12,000 income from discontinued operations is considered in determining the tax benefit that is allocated to continuing operations. Under this guidance, the total income tax expense of $500 is allocated to continuing operations and discontinued operations as follows:

<table>
<thead>
<tr>
<th>Allocate income tax expense to continuing operations and other items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax benefit allocated to continuing operations (realizable pretax loss from continuing operations of $10,000 * 25% tax rate)</td>
</tr>
<tr>
<td>Income tax expense allocated to discontinued operations (total income tax expense less amount allocated to continuing operations or $500 - ($2,500) = $3,000)</td>
</tr>
<tr>
<td>Total income tax expense</td>
</tr>
</tbody>
</table>

In this example, the entire tax benefit from the loss from continuing operations is allocated to continuing operations.
The standard requires that the new intraperiod tax allocation guidance be applied prospectively in the period of adoption. The Board noted that the new guidance will not change the total reported amount of deferred taxes or total income tax expense. However, applying the new standard could affect the comparability of the financial statements in the period of adoption because the amount of income tax benefit allocated to continuing operations will be determined differently when there is a loss in continuing operations and a gain or income from other components.

**How we see it**

Companies that have losses from continuing operations and income from other categories in periods before and after adoption may need to consider whether to make additional disclosures in the notes to the financial statements or management discussion and analysis to help users understand the changes in the income tax expense allocated to continuing operations and effective tax rates.

Entities that prepare interim financial statements and are subject to the legacy exception will also need to consider the effect of the new guidance when determining their effective annual estimated tax rate in interim periods after adoption.

**Exception to the general methodology for calculating income tax for an interim period**

The amendments eliminate a legacy exception to the guidance on accounting for income taxes for interim periods. The interim reporting guidance in 740-270 addresses how and when income tax expense or benefit is recognized for an interim period and generally requires companies to make their best estimate of the annual effective tax rate for the full fiscal year in each interim period and apply that estimate to the year-to-date pretax income or loss to calculate income taxes on a year-to-date basis.

If an entity has year-to-date ordinary losses that exceed the anticipated ordinary loss for the year and the entity expects to realize a tax benefit for all anticipated ordinary losses, a legacy exception in ASC 740-270-30-28 limits the income tax benefit recognized in the year-to-date interim period to the amount of the tax benefit determined based on the year-to-date ordinary loss. That is, an entity is not permitted to recognize tax benefits in excess of the amount that would be recognized if its year-to-date ordinary loss were the anticipated ordinary loss for the year. Under the new guidance, an entity would no longer limit the tax benefit recognized in an interim period if it expects to realize a tax benefit.

The elimination of the exception will not change the total income tax expense or benefit an entity will recognize on an annual basis, but it may change the amount of income tax expense or benefit recognized in interim periods.

**How we see it**

The Board noted it required a prospective transition approach for this amendment because interim reporting does not affect the amount of deferred taxes or income tax expense reported at the end of the year and, therefore, will not affect the comparability of annual financial statements. However, applying the amendment prospectively might affect the comparability of interim periods in the year of adoption. Companies may need to consider additional disclosure if the application of this amendment significantly affects the comparability of their interim results.

**Exceptions to the recognition of deferred taxes when investment ownership changes**

The amendments eliminate the exceptions to the general requirements for recognizing and not recognizing a deferred tax liability (DTL) related to the outside basis differences (e.g., undistributed earnings) that predate changes in ownership of equity method investments and foreign subsidiaries. Instead, the guidance will require entities to account for the tax effects of the entire outside basis difference that relate to an investment in which there is an ownership change as if the entity had always accounted for the investment based on the new ownership structure.

The FASB said the exceptions add to the cost and complexity of accounting for outside basis differences and reduce comparability because they apply to only the portion of the outside basis difference of an investment that existed before the change in ownership.
Entity loses control of a foreign subsidiary

Under the legacy exception in ASC 740-30-25-15, an entity, under certain circumstances, is required to continue to not recognize a deferred tax liability on the outside basis differences of a foreign subsidiary (or a corporate joint venture that was essentially permanent in duration) that existed before it lost control and became an equity method investment. That is, if the parent entity did not recognize income taxes on its outside basis difference because of the assertion that undistributed earnings were indefinitely reinvested or remitted in a tax-free manner, the legacy guidance requires that the outside basis difference be “frozen” (and no deferred tax liability would be recognized). Eliminating this exception will require an entity with a foreign subsidiary that becomes an equity method investment to record a deferred tax liability for the total outside basis difference related to the equity method investment on the date of the ownership change (or earlier).

The following graphic compares the legacy guidance with the new guidance when an entity loses control of a foreign subsidiary.

Entity gains control of a foreign equity method investment

Under the legacy exception in ASC 740-30-25-16, an entity is required to “freeze” a deferred tax liability previously recognized for a foreign equity method investment if the investee becomes a subsidiary, even if the entity is able to apply the recognition exceptions in ASC 740 (for example, after obtaining control, the foreign earnings for periods prior to gaining control are indefinitely reinvested or can be remitted in a tax-free manner). The new guidance allows an entity to apply the exceptions to recognizing deferred tax liabilities on its outside basis differences that predate the change in ownership if it asserts its intent and it has the ability to indefinitely reinvest those earnings or remit them in a tax-free manner.
The following graphic compares the legacy guidance with the new guidance when an entity gains control of a foreign equity method investment.

How we see it

Requiring an entity to account for the tax effects of an entire outside basis difference that relates to a foreign investment based on the new ownership level will improve the comparability of financial statements and reduce the complexity of accounting for outside basis differences.

Other simplifications

**Allocation of consolidated income tax expense to separate financial statements of entities not subject to income tax**

The legacy guidance in ASC 740-10-30-27 requires the consolidated amount of current and deferred tax expense for a group that files a consolidated tax return to be allocated among the members of the group when those members issue separate financial statements. The new guidance clarifies that an entity is not required to allocate the consolidated amount of current and deferred tax expense to the separate financial statements of legal entities that are not subject to tax.

However, the new guidance allows an entity to make an election to allocate the consolidated amount of current and deferred tax expense to the separate financial statements of legal entities that are both not subject to tax and disregarded by the taxing authority (e.g., a single-member limited liability company or SMLLC). The election is not required for all such members of a group that file a consolidated tax return. Therefore, an entity may elect to do so in the separate legal entity financial statements on an entity-by-entity basis. An entity cannot make the election to allocate the consolidated amount of current and deferred tax expense for legal entities that are partnerships or other pass-through entities that are not wholly owned.

Stakeholders had said that, under the legacy guidance, some groups that file consolidated tax returns allocate a portion of the current and deferred tax expense to SMLLCs not subject to income tax for presentation in the SMLLCs’ separate financial statements, while others do not. The FASB added the clarification to address this diversity in practice.

The FASB said it is allowing SMLLCs and other similar disregarded entities (that are wholly owned by the entity) that are not subject to income tax to recognize an allocation of income taxes in their separate financial statements because certain entities (e.g., rate-regulated entities) may need to do so for business reasons. However, an SMLLC or a similar disregarded entity that elects to recognize such an allocation must disclose that fact and provide certain other disclosures required by ASC 740.
Accounting for the interim period effects of changes in tax laws or rates

The new guidance requires an entity to reflect the effect of an enacted change in tax laws or rates in the annual effective tax rate computation in the first interim period that includes the enactment date of the new legislation. This amendment aligns the timing of recognition of the effects from enacted tax law changes on the effective tax rate with the effects on deferred tax assets and liabilities by requiring both effects to be recognized in the interim period, including the enactment date.

The legacy guidance in ASC 740 requires an entity to recognize the effect of the enacted tax law on deferred tax assets and liabilities in the period of enactment and the effect of the enacted tax law on the annual effective tax rate (i.e., on the interim period income tax calculation) in the period that includes the effective date of the tax law.

Accounting for franchise taxes

Certain jurisdictions impose franchise taxes (or other similar taxes) that are calculated using the greater of two tax computations: one based on income and the other based on items other than income.

To reduce complexity in the calculation and recognition of deferred taxes, the new guidance amends ASC 740-10-15-4 to require entities to recognize the franchise tax by (1) accounting for the amount based on income under ASC 740 and (2) accounting for any residual amount as a non-income-based tax.

The legacy guidance in ASC 740 requires companies subject to this type of franchise tax (or other similar tax) to first account for the amount calculated based on items other than income as a non-income-based tax and then account for any residual amount under ASC 740.

The amendments provide guidance on the measurement of deferred tax assets and liabilities, stating they should be measured using the applicable statutory income tax rate. The amendments also clarify that an entity should not consider the effect of potentially paying a non-income-based tax in future years when evaluating the realizability of its deferred tax assets.

Because the new guidance changes the order of how an entity determines the amount of franchise tax to account for as income tax, the reported amounts of pretax income and income tax expense could change. In addition, in the period of adoption, an entity may also be required to remeasure its deferred tax assets and liabilities. The Board decided that entities may adopt this provision on a retrospective basis for all periods presented or a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption.

How we see it

Because a franchise tax may be imposed in multiple state, local and foreign tax jurisdictions, companies will need to first identify all jurisdictions that impose taxes based on the greater of two tax computations that they currently account for using the legacy guidance. If the number of these types of taxes or amounts are significant, implementing the new franchise tax guidance may be challenging and may require an entity to change its accounting systems and processes.

Accounting for a step-up in the tax basis of goodwill

Certain jurisdictions allow corporate taxpayers to elect to step up the tax basis of certain assets in exchange for a current payment to the taxing authority or in exchange for existing tax attributes (e.g., NOL carryforwards). Under the legacy guidance in ASC 740-10-25-54, when the tax basis step-up relates to goodwill from an earlier business combination that was not deductible, a deferred tax asset is not recorded for the increase in tax basis except for any amount of newly deductible goodwill that exceeds the remaining balance of book goodwill.

Stakeholders indicated that, in some situations, applying the guidance in ASC 740-10-25-54 does not represent the economics of the transaction, particularly when the step-up in the tax basis of goodwill occurred as a result of the entity using cash or existing tax attributes.

The new guidance clarifies the existing guidance and requires an entity to determine whether the step-up in tax basis relates to (1) the business combination in which the book goodwill was initially recognized, in which case no deferred tax asset would be recorded for the increase in basis (except for any amount of newly deductible goodwill that exceeds the balance of book goodwill), or (2) a separate transaction, in which case a deferred tax asset would be recorded for the entire amount of the newly created tax deductible goodwill, subject to a valuation allowance.
The new guidance lists factors that may indicate that the step-up in tax basis relates to a separate transaction. These factors include, but are not limited to, the following:

- A significant lapse in time between the transactions has occurred.
- The tax basis in the newly created goodwill is not the direct result of the settlement of liabilities recorded in connection with the acquisition.
- The step-up in tax basis is based on a valuation of the goodwill or the business that was performed as of a date after the business combination.
- The transaction resulting in the step-up in tax basis requires more than a simple tax election.
- The entity incurs a cash tax cost or sacrifices existing tax attributes to achieve the step-up in tax basis.
- The transaction resulting in the step-up in tax basis was not contemplated at the time of the business combination.

**Codification improvements**

The new guidance also made other improvements to ASC 740. It specifies in ASC 718-740-45-7 that the tax benefit of tax-deductible dividends on allocated and unallocated employee stock ownership plan shares must be recognized in continuing operations. It also corrects an error in the example in ASC 323-740-55-8 of the accounting for an investment in qualified affordable housing projects accounted for using the equity method, among other things.

**Effective date and transition**

For public business entities (PBEs), the guidance is effective for fiscal years beginning after 15 December 2020 and interim periods within those fiscal years. For all other entities, the guidance is effective for fiscal years beginning after 15 December 2021 and interim periods within fiscal years beginning after 15 December 2022.

Early adoption is permitted in interim or annual periods for which PBEs have not yet issued financial statements and all other entities have not made financial statements available for issuance. Entities that elect to early adopt the amendments in an interim period should reflect any adjustments as of the beginning of the annual period that includes that interim period. Additionally, entities that elect early adoption must adopt all the amendments in the same period.

Entities will apply the amendments prospectively, except for the following amendments:

- The election to allocate a tax provision to the separate financial statements of legal entities that are both not subject to tax and disregarded by the taxing authority, which is applied retrospectively for all periods presented.
- The guidance on ownership changes to a foreign equity method investment or foreign subsidiary, which is applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption.
- The guidance on franchise taxes that are partially based on income, which is applied either retrospectively for all periods presented or using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption.

The guidance requires entities to make certain transition disclosures.

**How we see it**

- Entities may want to consider early adopting the guidance because it will simplify the accounting for income taxes, especially in the areas where exceptions to the general approaches in ASC 740 were eliminated.
- Entities should consider whether changes to their processes and internal controls are needed to implement the amendments.