Annual Institute on Current Issues in International Taxation

Partnership Issues

December 14, 2023

The Panel

Session Chair

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Panelists

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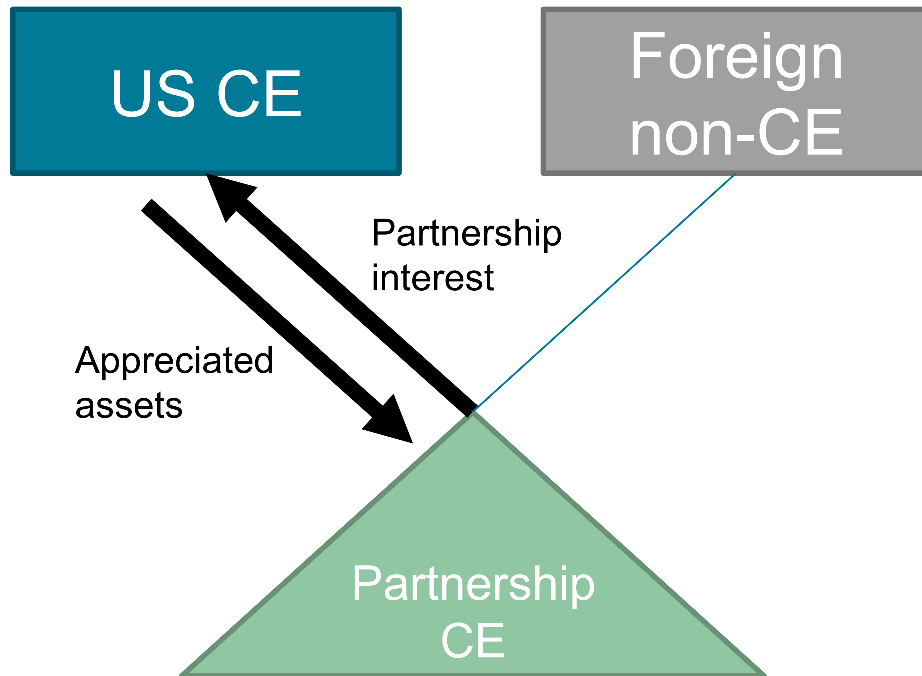
Agenda

- Pillar 2 issues involving partnerships
- Aggregate/entity analysis under AM 2023-003 (FIRPTA partnership GLAM)
- Corporate Minimum Tax (CAMT) and cross-border partnerships

Guidance Update

Pillar 2 Issues Involving Partnerships

Partnership Formation/Contribution

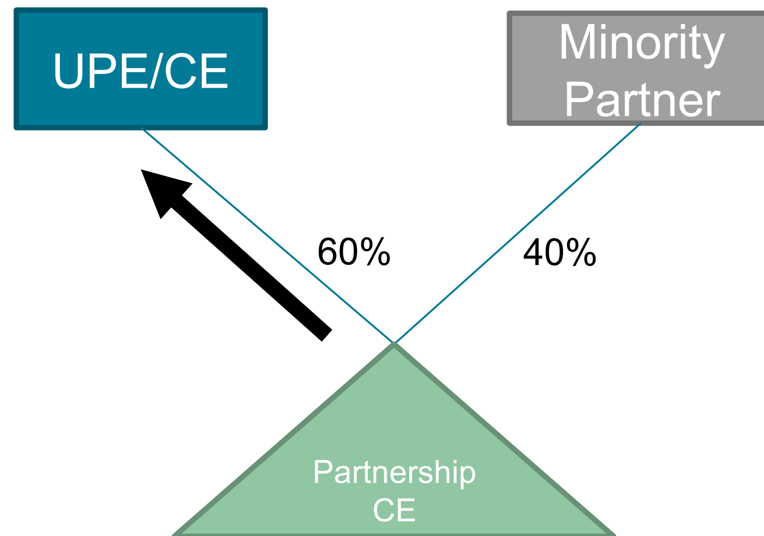


- Contribution by US CE generally receives nonrecognition treatment for tax purposes
- May be recorded at fair value for accounting purposes
- Article 6, paragraph 17 of the commentary states that deferred tax items associated with purchase accounting adjustments, including those "arising in connection with a GloBE Reorganization that is subject to the rules of Article 6.3.2," must be excluded "to prevent distortions in the ETR computations."

Operations: Aggregate vs. Entity Treatment

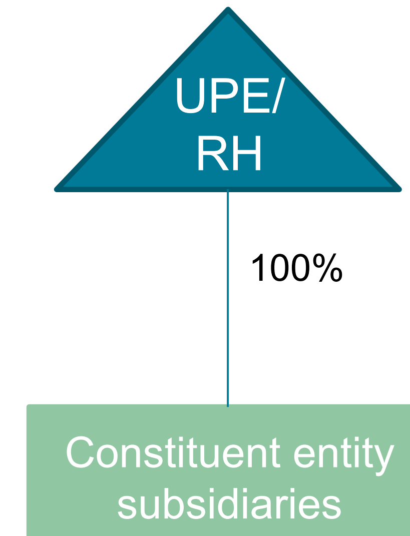
Aggregate

When partnership is a constituent entity and is tax transparent, relevant ETR is determined at level of constituent entity owners in accordance with % interest

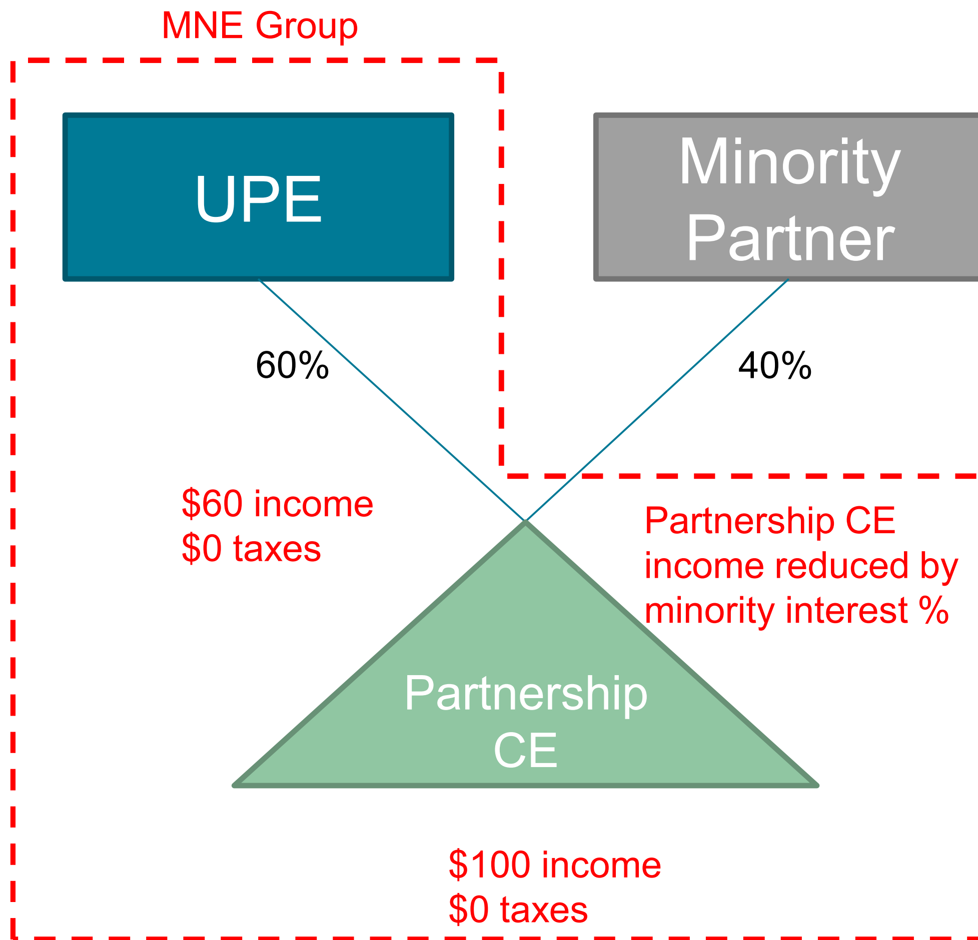


Entity

When partnership is UPE or to the extent a "reverse hybrid" with respect to a constituent entity owner, relevant ETR is determined at partnership level

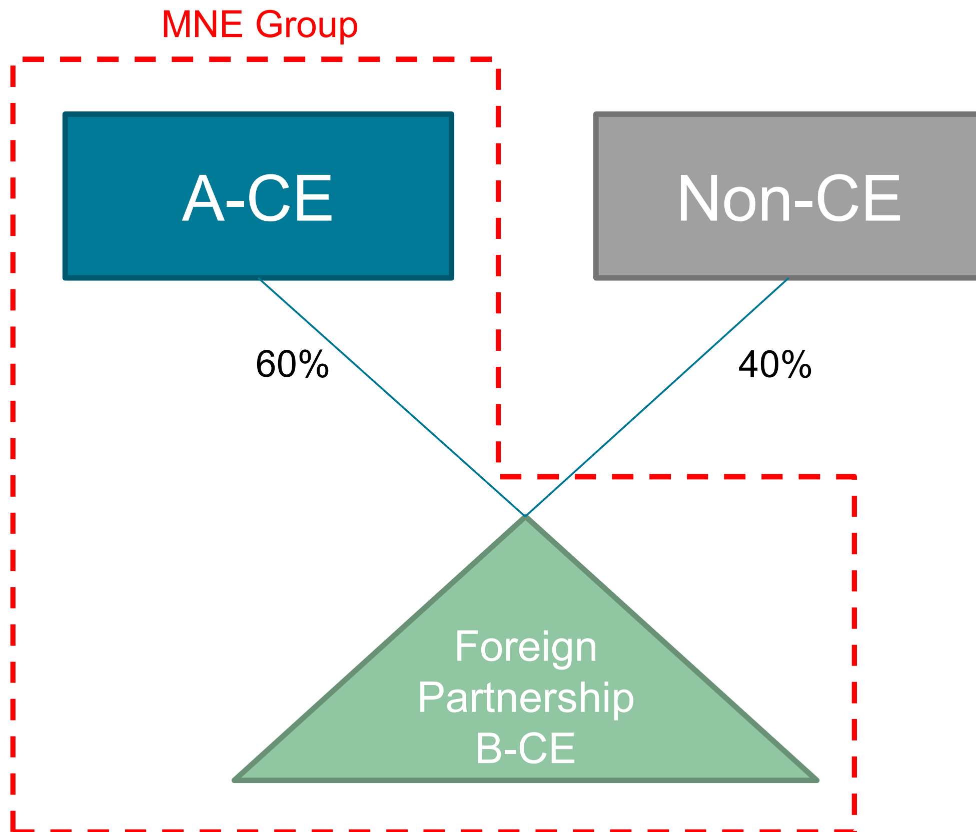


CE Partnership Allocations – General Rule



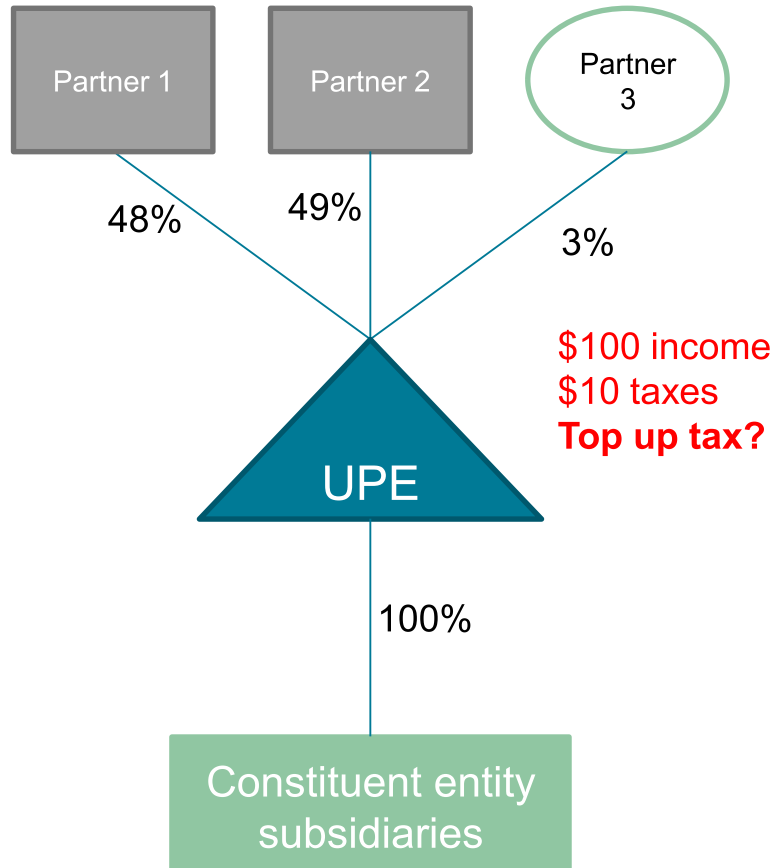
- Tax transparent entity – treated as fiscally transparent by constituent entity owner's jurisdiction
- Partnership income/taxes first reduced by amounts attributable to minority owners (owners that are not part of the MNE group)
- Remaining income/taxes allocated to the constituent entity owners

Special Allocations – Commentary Example



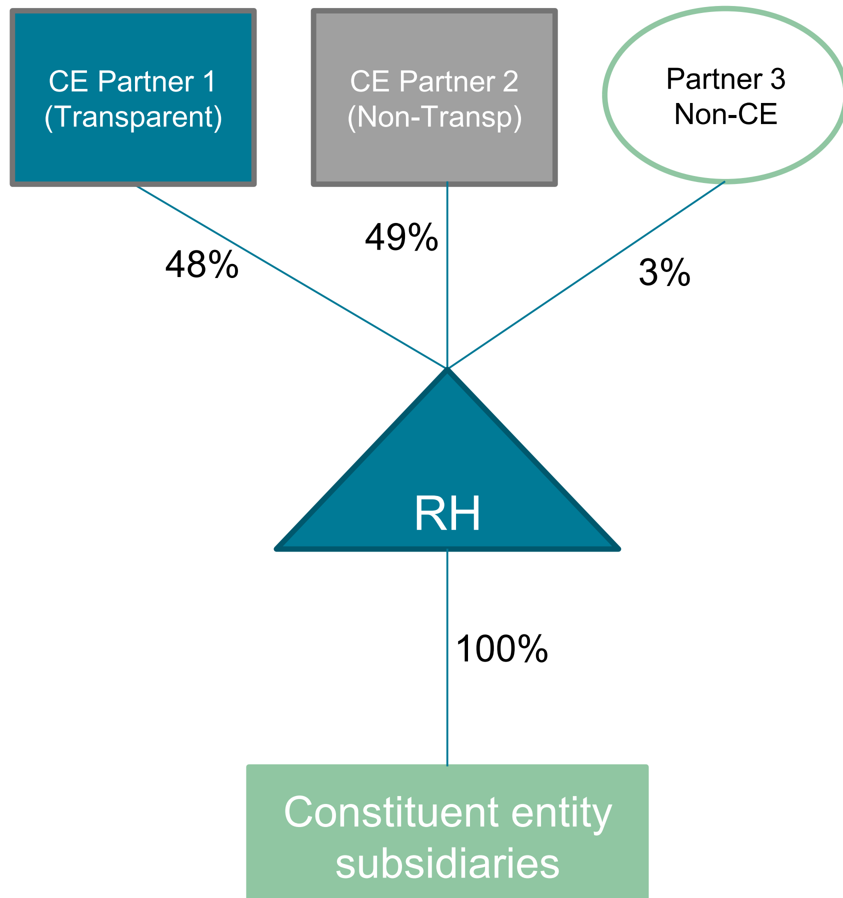
- Commentary example (commentary to Article 3.5.1 of model rules):
  - 60% foreign partnership B-CE owned by A-CE
  - 40% owned by non-CE
  - Special contract allocation gives A-CE an additional 10% profits interest years 1 – 5
  - Country A does not respect 10% additional allocation for tax purposes
- Result:
  - A-CE is allocated 70% of partnership's income
  - Country A's tax treatment is not relevant

Partnership as UPE



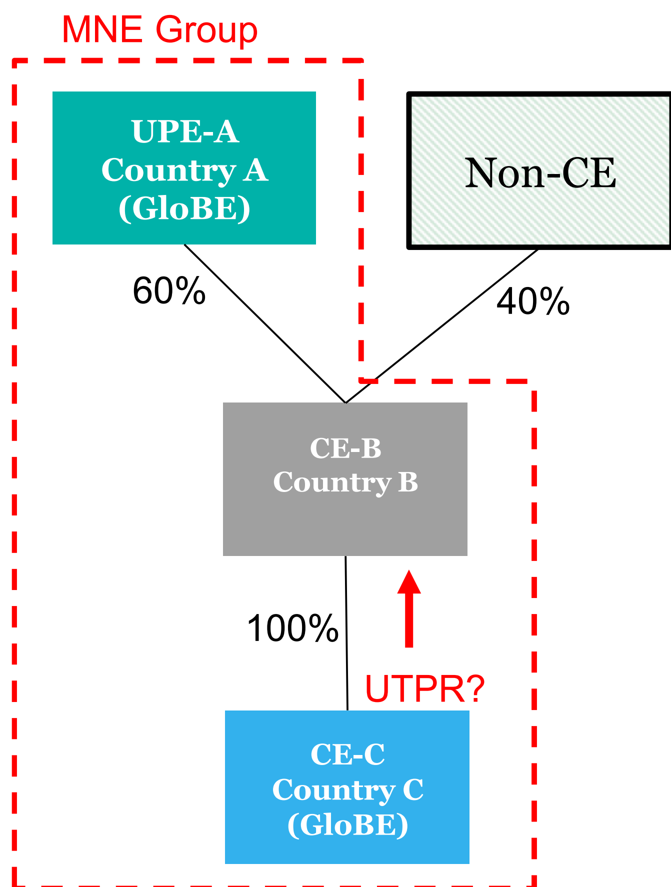
- A partnership may be the UPE of an MNE Group
- Income earned by or assigned to the UPE partnership is assigned to the UPE's jurisdiction
  - Because taxes will not generally be paid in the UPE's jurisdiction on partnership income, relevant ETR will often fall below 15%
  - Top-up tax could then be collected under the IIR or UTPR
- Income otherwise assigned to a partnership UPE may be reduced in proportion to:
  - Direct (and indirect?) ownership interests in the UPE partnership that are subject to a nominal tax rate of at least 15%, or are reasonably expected to be subject to sufficient aggregate tax
  - Small (≤ 5%) direct ownership interests held by:
    - Natural persons resident in the UPE's jurisdiction, or
    - Governmental entities, international organizations, non-profits, or pension funds

Reverse Hybrid



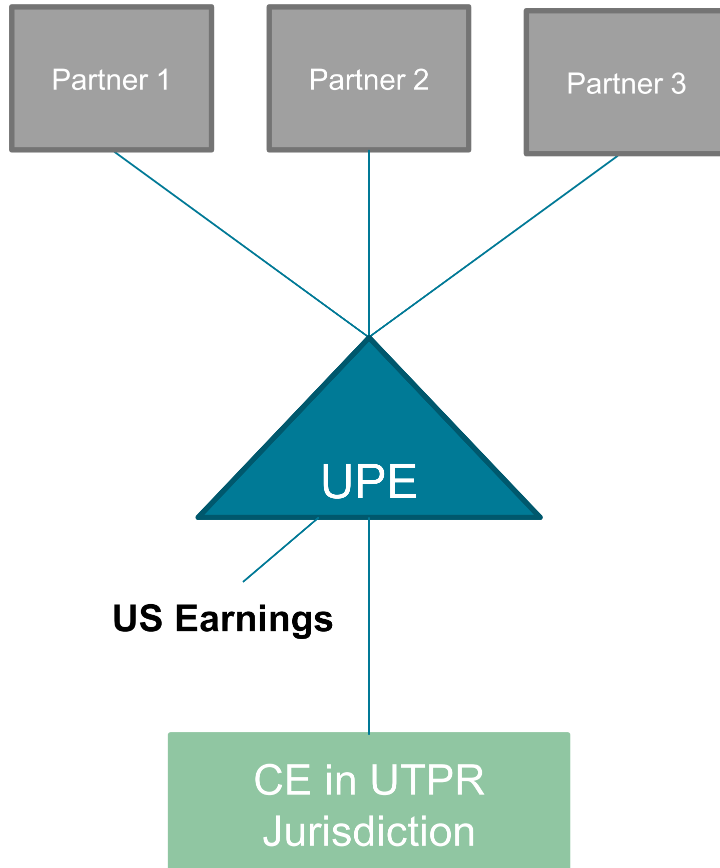
- A non-UPE partnership will be treated as a Reverse Hybrid to the extent the entity is not tax transparent in the jurisdiction of one or more constituent entity owners
  - Analysis performed separately for each partnership interest
- 3% income/taxes reduced for non-CE owners
- 48% income/taxes assigned to CE Partner 1 (treats partnership as transparent)
- 49% income/taxes assigned to RH and relevant ETR determined at RH on this portion (treats partnership as RH)

Contrast: Corporate JVs



- Some definitions:
  - Partnership = Flow Through Entity = tax transparent in the jurisdiction in which the entity is formed/operates
  - Corporate JV = non-tax transparent in the jurisdiction in which the entity is formed/operates
- Corporate JV - relevant ETR determination is made at the CE-B level
- None of CE-B's income is excluded for non-CE owners
- IRR imposed on UPE-A by jurisdiction A allocated to CE-B; no other taxes may be allocated to CE-B from non-CE owners
- If Country C has adopted the UTPR, could Country C collect top-up tax on the remaining 40% top-up tax of CE-B?

Transitional UTPR Safe Harbor: UPE Flowthrough



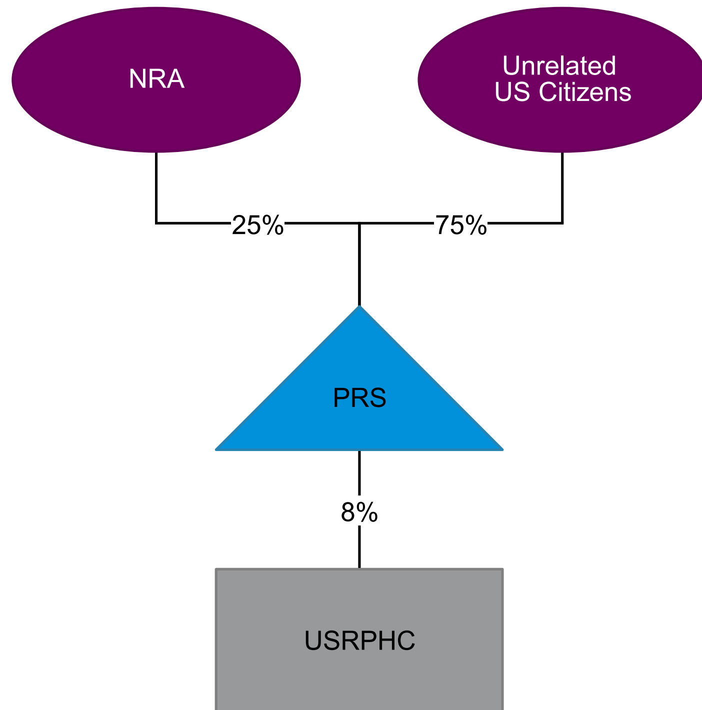
- UTPR Safe Harbor (July 2023) provides that the UTPR Top-up Tax Amount calculated for the UPE Jurisdiction shall be deemed to be zero for each Fiscal Year during the Transition Period if the UPE Jurisdiction has a corporate income tax that applies at a rate of at least 20%.
- Transition Period means the Fiscal Years which run no longer than 12 months that begin on or before 31 December 2025 and end before 31 December 2026.
- Thus, US based multinationals that would otherwise be subject to a UTPR appear generally to be able to avoid UTPR for its first year of applicability (FY2025) with respect to any US earnings.
- The rule appears to also apply when UPE is a Flow-through Entity even though it pays no corporate tax.

Aggregate/entity analysis under AM 2023-003

FIRPTA Basics

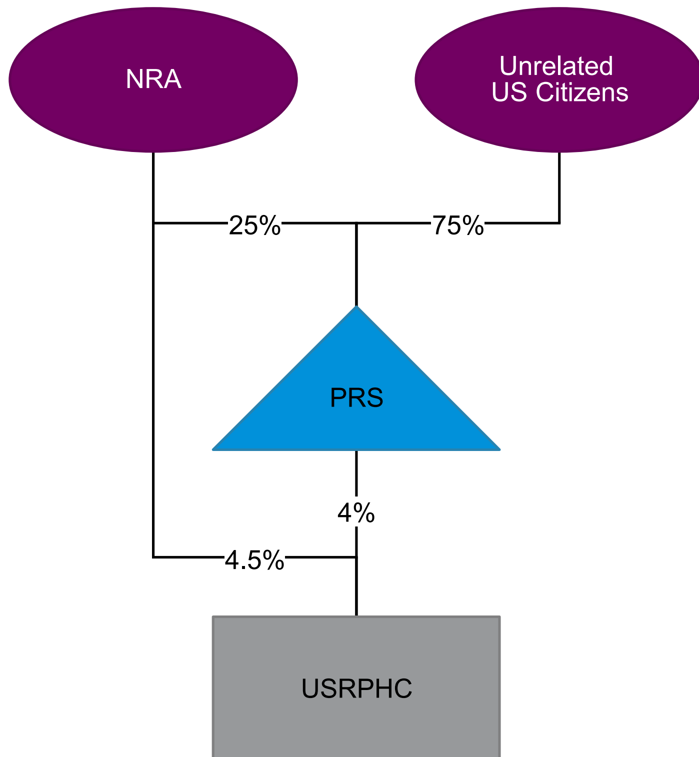
- Section 897(a)(1): gain or loss of NRA or foreign corporation on the disposition of a USRPI is treated as ECI
- Section 897(c)(1)(A): USRPI includes stock of a US corporation unless established that the USCo was not a USRPHC during the 5 year period ending on the date of the disposition
- Section 897(c)(3): Any class of stock that is regularly traded is treated as a USRPI **only if** a **person** held more than 5% of such class of stock (the "regularly traded exception")
  - "Person" includes a partnership per section 7701(a)(1)

AM 2023-003, Situation 1



- NRA owns 25% of PRS. US citizens own remaining 75%
- PRS holds 8% of USRPHC
- PRS disposes of USRPHC stock
- Does the regularly traded exception apply?
  - PRS holds 8% of USRPHC
  - NRA indirectly holds interest in 2% of USRPHC
  - GLAM says NO regularly traded exception available

AM 2023-003, Situation 2



- NRA owns 25% of PRS. US citizens own remaining 75%
- PRS holds 4% of USRPHC
- NRA directly holds 4.5% of USRPHC
- NRA disposes of 4.5% interest in USRPHC stock
- Does the regularly traded exception apply?
  - NRA indirectly holds interest in 5.5% of USRPHC
  - GLAM says NO regularly traded exception available

AM 2023-003 Rationale

- Section 897(c)(3): Any class of stock that is regularly traded is treated as a USRPI only if a person held more than 5% of such class of stock (the "regularly traded exception")
  - "Person" includes a partnership per section 7701(a)(1)
  - IRS: The determination should be at the partnership level unless it is more appropriate for the partnership to be treated as an aggregate for this purpose
- "A regularly traded interest owned by a person who beneficially owned more than 5% of the total fair market value…"
  - Treas. Reg. 1.897-1(c)(2)(iii)(A)
- The preamble to the early FIRPTA regulations concludes that "only foreign persons holding a greater than five percent interest will be subject to Section 897 on sale of their interests."
  - TD 7999 (December 31, 1984)

Entity Approaches in International Context

- AM 2023-003
- NRA or foreign corporation treated as ETB in the US if the partnership is so engaged
  - Section 875(a)(1)
- ETB safe harbor applied at the partnership level
  - Section 864(b)(2), Treas. Reg. 1.864-2(c)(2)(ii), Treas. Reg. 1.864-2(d)(2)(ii)
- A PE of the partnership is attributed to the partner for treaty purposes
  - Unger v. Comm'r, 936 F. 2d 1316 (D.C. Cir. 1991)
- Determination of a foreign corporation as a CFC takes an entity approach
  - Treas. Reg. 1.958-1(d)(2)

Aggregate Approaches in International Context

- Partners of a foreign partnership are the beneficial owners of income paid to the foreign partnership.
  - Treas. Reg. 1.1441-1(c)(6)(ii)(B)
- Portfolio interest exception tested at the partner level
  - Treas. Reg. 1.871-14(g)(3)(i)

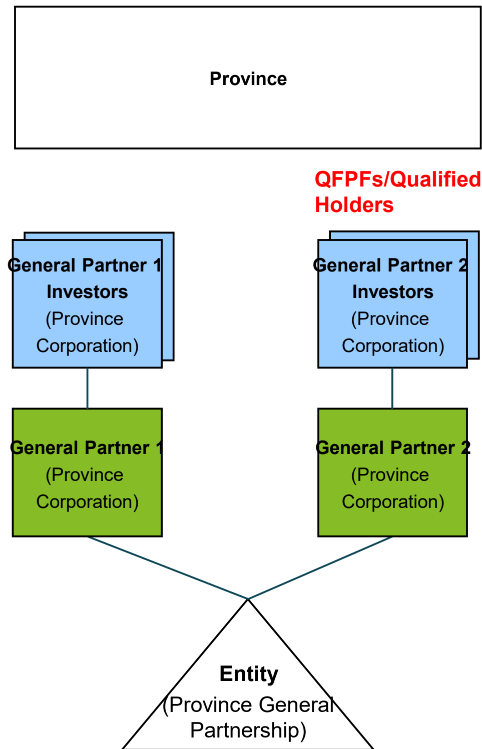
Aggregate Approaches in International Context (cont'd)

- GILTI inclusion only if the partner is an indirect US Shareholder
  - Preamble to the final regulations explicitly acknowledges switch to aggregate approach
  - TD 9866 (June 21, 2019); Treas. Reg. 1.951A-1(d)
- Domestic partnerships treated as aggregates for many Subpart F purposes
  - Subpart F inclusion only if the partner is an indirect US Shareholder of the CFC
  - TD 9960 (January 25, 2022); Treas. Reg. 1.958-1(d)(1)
- Recent regulations changed from an entity approach to an aggregate approach for purposes of QEF elections
  - TD 9960 (January 25, 2022); Prop. Treas. Reg. 1.1291-1(b)(7) (shareholder of a PFIC expressly excludes domestic partnerships)

Where does this leave us?

- Trend towards aggregate approach in the international context
- Taxpayers can't rely on informal guidance of an AM
  - But may chill investment by non-US persons in USRPHCs
- In situation 2, consider the partnership's obligation to withhold under section 1446(a) when it lacks information about the USRPHC holdings of its (direct and indirect) partners
- Are regulations forthcoming?

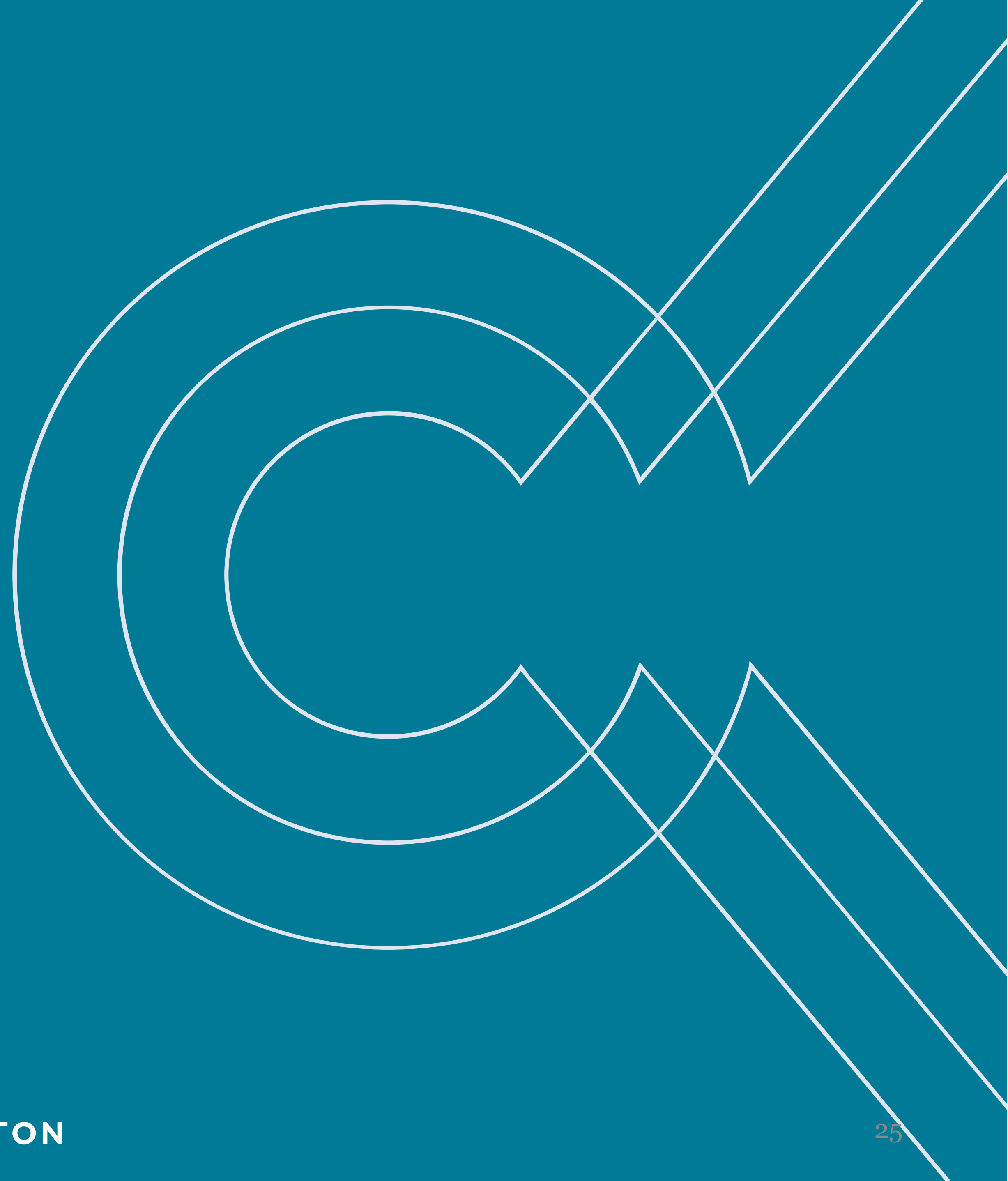
Recent Section 892 PLRs



- On October 27, 2023, the IRS released three letter rulings – PLR202343034, PLR 202343035, and PLR202343036 – that addressed the U.S. tax classification of partnerships held by multiple controlled entities of the **same** foreign government.
- PLRs addressed:
  - Whether the Entity is treated as a corporation pursuant to Treas. Reg. § 301.7701-2(b)(6).
  - Whether the Entity is treated as a corporation pursuant to Treas. Reg. § 301.7701-2(b)(7) by reason of section 892(a)(3).
- Held: on applicable facts, entity owned by multiple foreign sovereigns not a "per se" corporation/can be a partnership for U.S. tax purposes

CAMT and Cross-Border Partnerships

CAMT Overview



CAMT Overview

Basics

- Minimum tax based on financial statement income (“FSI”) of “applicable corporations”
- Applies to large companies or groups using a >$1b three-year average annual “adjusted FSI” (“AFSI”) threshold
- Creates a tax credit that carries forward indefinitely

Process

- AFSI determines whether a taxpayer is an applicable corporation (“Scope Determination”) and the calculation of potential CAMT liability (“Liability Determination”)
- AFSI is calculated differently for both
  - AFSI is a blend of tax and accounting concepts
- Audit and tax considerations:
  - CAMT will impact provision consideration (for many filers, this creates a Jan/Feb 2024 deadline)
  - CAMT needs to be taken into account for 2023 extension payments (for many taxpayers, this creates an April 2024 deadline)

CAMT Guidance

Guidance to Date

- Four notices and a draft 2023 Form 4626 released so far
  - Notice 2023-7
    - Released: 12/27/22
    - Initial CAMT guidance
    - Included scope determination safe harbor method
  - Notice 2023-20
    - Released: 2/17/23
    - CAMT interim guidance for the insurance industry
  - Notice 2023-42
    - Released: 6/7/23
    - Estimated tax relief for corporations – no requirement for 2023 estimated taxes in connection with CAMT

CAMT Guidance (cont'd)

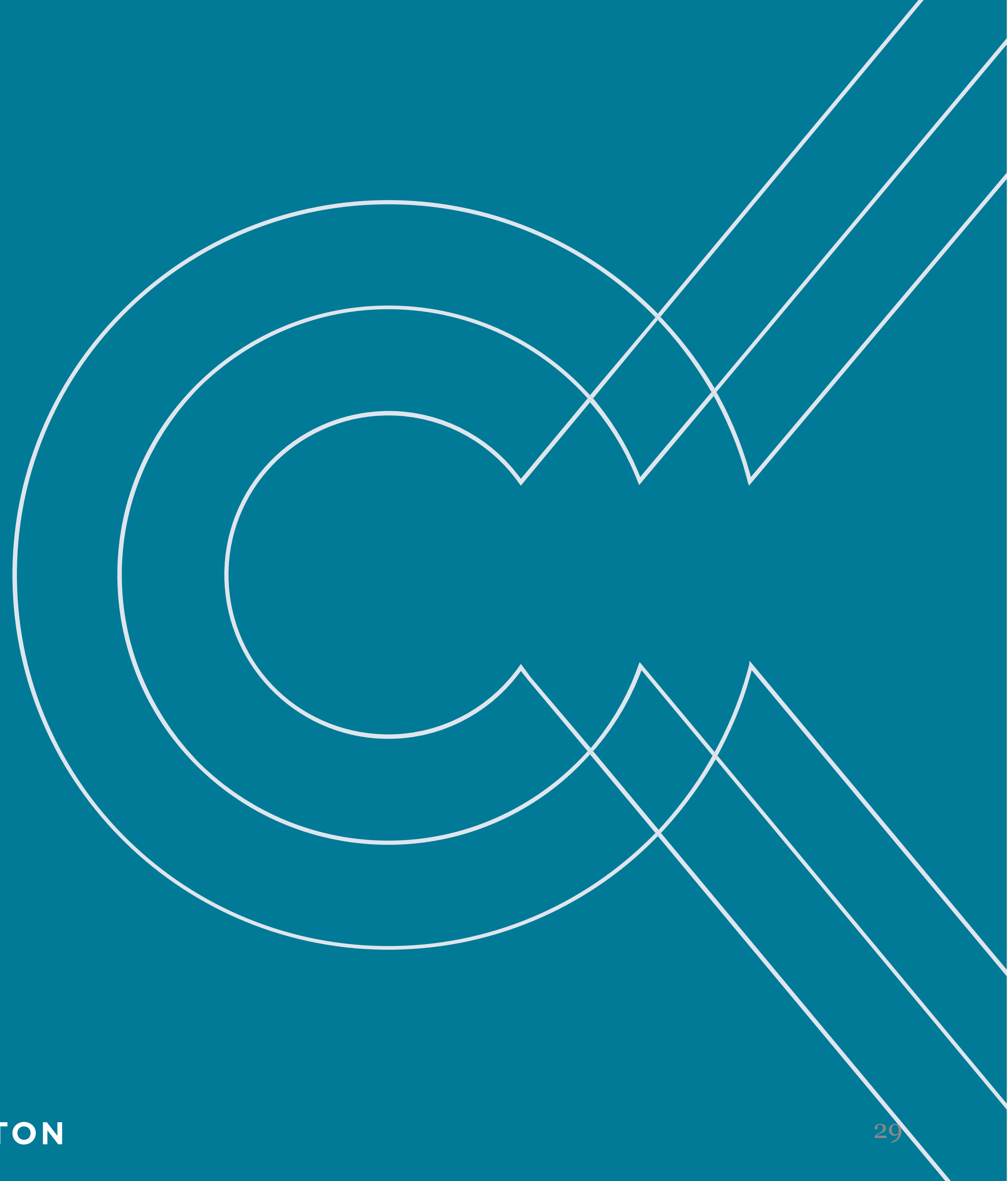
Guidance to Date (cont'd)

- Draft 2023 Form 4626
- Notice 2023-64 (the "Notice")
  - Released: 9/12/2023
  - Additional guidance on the application of CAMT

Guidance to Come

- Proposed regulations expected to be applicable for tax years beginning on/after January 1, 2024 (per Notice 2023-64)

Notice 2023-64



AFS Determination

Guidance on which financial statement to use for CAMT

- Provides a strict hierarchy of which financial statement is the correct applicable financial statements (“AFS”) that departs from section 451(b)(3) in many important respects
- Five categories of financial statements in order of priority:
    1. U.S. GAAP statements
    2. IFRS statements
    3. Other government and regulatory statements
    4. Unaudited external statements
    5. Federal income tax or information returns filed with the IRS
- Special rule for U.S. taxpayers who are members of a FPMG

Determining AFSI

Clarifies what is and is not included in AFSI for certain categories

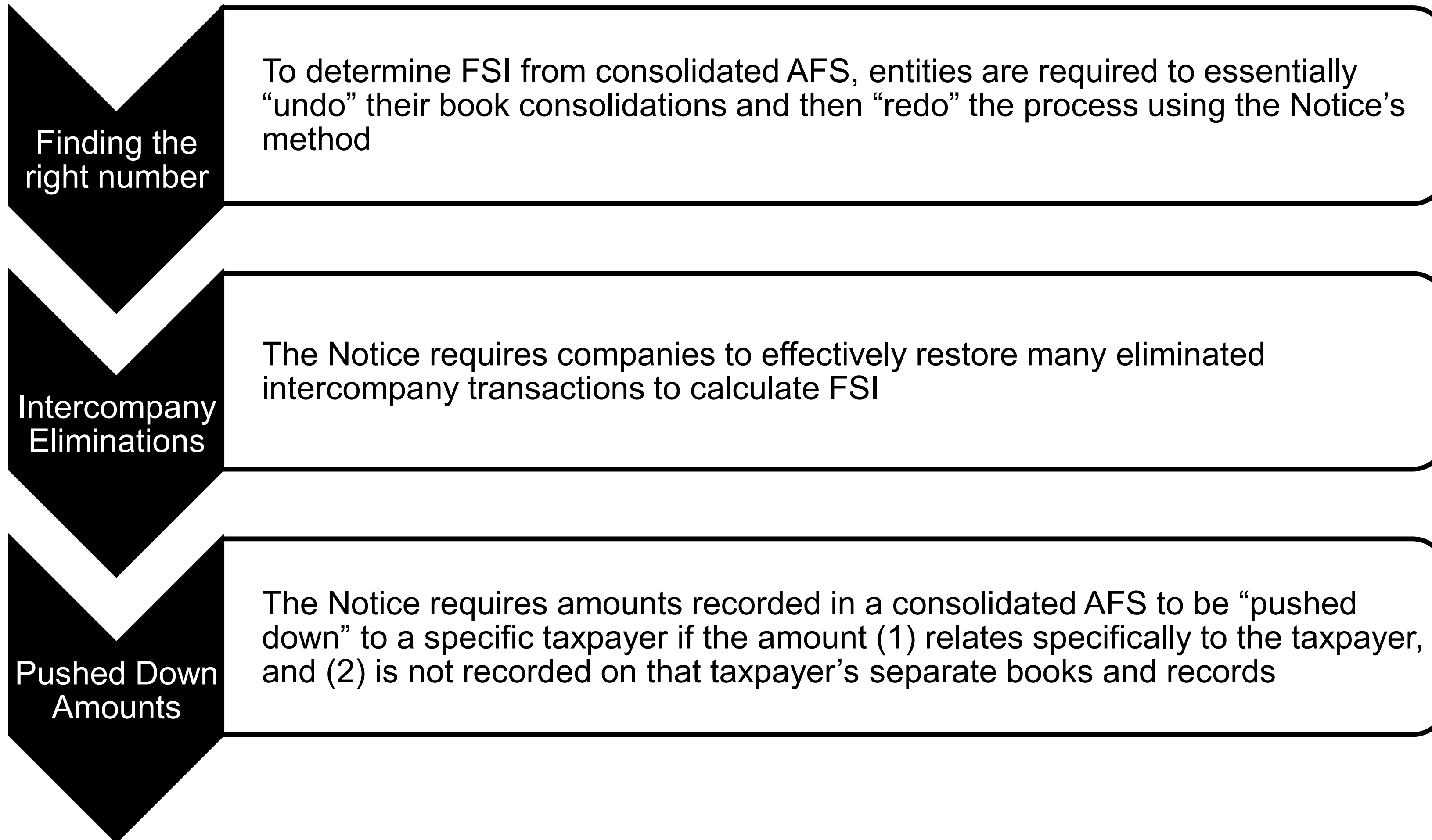
- Items of income do not need to be recognized, realized, or otherwise taken into account for regular tax purposes to be included in FSI or AFSI
  - Example: If a corporation that otherwise had $750 million in average annual AFSI sold a business and that sale resulted in $900 million of book (and tax) gain, the corporation would become an applicable corporation
- Amounts included in FSI due to the use of a fair value or mark-to-market method of accounting under U.S. GAAP or IFRS may be included in AFSI before inclusion in taxable income for regular tax purposes (unless the statute or guidance provides otherwise)
- AFSI does not include amounts reported outside of the AFS's net income amount (e.g., retained earnings, OCI)
  - OCI explicitly excluded from base
  - Retained earnings generally excluded; but changes to retained earnings may be taken into account under the "duplications and omissions" rule

Determining FSI from a Consolidated Financial Statement

Guidance requires “cracking” and “repacking” consolidated financial statements in many instances, with complex rules regarding elimination entries

- When determining FSI and AFSI for a taxpayer that is a member of a consolidated AFS, the Notice sets forth a process where entities essentially “undo” their book consolidation process and then “redo” it using a process set forth in the Notice
- Key features
  - No-netting rule
  - Elimination entries generally restored
    - Exceptions to entries that relate to (1) members of the same TCG or (2) the taxpayer and any DRE of the taxpayer
    - Consider intercompany transaction
  - Expenses booked top-side
    - AFS consolidation entries (such as for shared expenses) which are not reflected in the separate books and records of the taxpayer must be allocated to each taxpayer
    - Consider stock comp
  - Partnership sentence (discussed later)

Determining FSI from a Consolidated Financial Statement



Depreciation

- Adjustments to AFSI for tax depreciation of section 168 property expanded to include:
  - Depreciation capitalized and recovered under other provisions
  - Section 481(a) adjustments for tax depreciation method changes
- Adjustments to AFSI for qualified wireless spectrum generally mirror tax depreciation adjustments
- AFSI adjusted for dispositions of section 168 property and qualified wireless spectrum when disposition event occurs for regular tax purposes
- No AFSI adjustment for tax gain or loss nonrecognition or deferral provisions (e.g., installment method, like-kind exchanges, etc.) other than in the context of covered nonrecognition transactions

Partnership Issues

Partnership scope rule generally simplified

- Corporate partners generally will not need additional information from partnerships to determine if they are in scope
  - Generally, use FSI pickup (no section 56A adjustments)
- Exceptions, when partnership is
  - Section 52 single employer group member
  - FPMNG member
  - Book consolidated but (i) NOT section 52 single employer group member OR (ii) NOT FPMG member
    - Section 5 “partnership sentence”
      - When does it apply? Does it only apply to a taxpayer that book consolidates an investment in a partnership where the partnership is not part of the taxpayer’s section 52 single employer or foreign partnership group?

Partnership Issues (cont'd)

- When it applies, how much do you include? Hypothetical equity method pick-up? Net income attributable amount (i.e., subtract non-controlling interests)? Income attributable to the partnership if a "parent-only financial statement" was prepared?

- Owned by a CFC
  - There is a seeming internal conflict in Notice 2023-64; inclusion appears to be either
    - (1) Pro rata share of the CFC's items comprising Adjusted Net Income or Loss including CFC's distributive share of Partnership AFSI; or
    - (2) Pro rata share of the CFC's items comprising Adjusted Net Income or Loss including FSI reported with respect to Partnership

Key International Issues

- **No relief (yet?) for CFC double counting issue**
  - The Notice confirms that a U.S. shareholder of a CFC must generally apply both section 56A(c)(2)(C) and section 56A(c)(3) with respect to a CFC
  - Acknowledges that the application of the CAMT statute to CFCs has the potential to double count CFC income in AFSI but offers no relief in this area; Notice requests comments on this issue

- **Definition of FPMG expanded**
  - For purposes of applying the FPMG $1 billion AFSI test, the Notice provides that AFSI includes both:
    - the AFSI of all other members of the foreign parent’s book consolidated group, and
    - the AFSI of all persons treated as a single employer under section 52 (whether or not such persons are members of the foreign parent’s book consolidated group)

Key International Issues (cont'd)

- **CAMT FTC**
  - Clarifies that a foreign tax (whether a CFC tax or direct tax) becomes eligible to be claimed as a CAMT FTC in the year it is paid or accrued for U.S. federal income tax purposes by either an applicable corporation or a CFC, "provided [such foreign tax] has been taken into account on the AFS" of such applicable corporation or CFC
  - Clarifies that foreign tax redeterminations are only eligible for a CAMT FTC if the taxpayer was an applicable corporation in the year to which the foreign tax redetermination relates
  - Clarifies that an applicable corporation or CFC partner can credit its share of foreign income taxes paid at the partnership level for CAMT

Other Issues

- Adjustment to AFSI for certain taxes includes both current and deferred federal and foreign income taxes
  - Items stated net of federal and foreign income taxes are adjusted to disregard the taxes
- Wide net cast for adjustments to AFSI to prevent omissions or duplications
  - For example, AFSI adjustment might be required any time retained earnings is adjusted in taxpayer's AFS
- No transition rule
  - No adjustments to AFSI for book-tax timing differences (unless otherwise specified) even if originated pre-CAMT effective date and reverses post-CAMT effective date
- Financial statement NOL carryforward includes AFSI losses for tax years ending after December 31, 2019 (to the extent not offset in subsequent years), regardless of when taxpayer becomes an applicable corporation

Questions?