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Quarterly tax developments

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

December 2021

Welcome to our December 2021 Quarterly tax developments *publication.*

Here we describe certain tax developments previously summarized in Tax Alerts or other EY publications or identified by EY tax professionals or EY foreign member firms. These developments may affect your tax provision or estimated annual effective tax rate.

We compile this information because we recognize that, for many companies, the most challenging aspect of accounting for income taxes is identifying changes in tax law and other events when they occur so the accounting can be reflected in the appropriate period. However, this publication is not a comprehensive list of all changes in tax law and other events that may affect income tax accounting.

This edition covers certain enacted tax legislation identified through 15 December 2021, as well as regulatory developments, legislative proposals and other items.

We list EY publications that you can access through our ***Tax News Update website****, if you are registered. Anyone interested in registering should contact Joan Osborne at* ***joan.osborne@ey.com****.*

See our ***previous editions*** *for additional tax developments.*

Tax developments

Legislation enacted in the fourth quarter

Federal, state and territories

Federal – On 15 November 2021, President Biden signed into law the Infrastructure Investment and Jobs Act (HR 3684), which repeals employee retention credits (ERCs) as of 30 September 2021. The repeal of ERCs will effectively cut the extension under the American Rescue Plan Act of 2021 in half by retroactively eliminating ERCs for the fourth quarter of 2021. Thus, wages paid after 30 September 2021 are not eligible for the credit, but may be deducted against an employer's income. See **Tax Alert 2021-2075**, dated 12 November 2021.

Illinois – On 16 November 2021, Illinois enacted legislation extending the state's carryover period for net loss deductions to 20 years from 12 years. The change applies to net operating losses (NOLs) generated in tax years ending on or after 31 December 2021 and to earlier NOLs for which the 12-year carryover period has not yet expired. See **Tax Alert 2021-2119**, dated 19 November 2021.

North Carolina – On 18 November 2021, North Carolina enacted legislation phasing out the corporate income tax over five years. The rate decreases to 2.25% from 2.5% for tax years beginning on or after 1 January 2025. It then decreases to 2% in 2026 and 2027, and to 1% in 2028 and 2029. After 2029, the rate decreases to 0%.

Other changes include:

- Modifying the definition of "qualified interest expense" so that the state limitation on deductions for the proportional share of interest paid to a related party does not apply to interest payments that have already been disallowed under Internal Revenue Code (IRC) Section 163(j) (retroactive to tax years beginning on or after 1 January 2018)
- Allowing companies to deduct, for North Carolina corporate income tax purposes, expenses paid with loans forgiven under the Paycheck Protection Program (generally effective for tax years beginning 1 January 2022)
- Allowing companies to deduct, over five years, interest expense that was disallowed for state tax purposes as a result of North Carolina's decoupling from changes made to IRC Section 163(j) by the Coronavirus Aid, Relief, and Economic Security Act, beginning with tax year 2021

See **Tax Alert 2021-2174**, dated 2 December 2021.

IRC conformity

The following chart lists the states that enacted legislation this quarter updating their date of conformity to the US IRC. The chart also includes the dates on which the new conformity date was enacted and became effective. Further information on a state's IRC conformity can be found in the cited reference.

State	Enactment date	Date of conformity	Effective date	Reference
North Carolina	18 November 2021	1 April 2021	Upon enactment	**Tax Alert 2021-2174**, dated 2 December 2021

International

Ecuador[*] — On 29 November 2021, Ecuador enacted legislation that replaces its progressive rate structure for capital gains taxes on share transfers with a flat 10% rate. A 22% corporate income tax rate applies to income from new investment projects, while a 20% income tax rate applies to income from developing new investments, provided an investment contract was signed with the Government. The change is effective upon the date of enactment.

Indonesia — On 29 October 2021, Indonesia enacted legislation canceling a previously enacted decrease in its corporate income tax rate, which would have been 20%. Rather than decreasing to 20% effective 1 January 2022, the corporate income tax rate will remain 22%. The rate for Indonesian-listed companies, however, will decline to 19% in certain circumstances. Other changes include replacing the current thin-capitalization rules, which are based on a debt-to-equity ratio, with forthcoming regulations that may be based on a certain ratio of loans to earnings before interest income and interest expense, taxes, depreciation, depletion, and amortization (EBITDA). The changes are effective upon enactment. See **Tax Alert 2021-2039**, dated 9 November 2021.

Israel — On 15 November 2021, Israel enacted legislation reducing the "clawback" corporate income tax rate on undistributed retained earnings (e.g., "trapped" earnings that were previously tax-exempt) by up to 60%, to a minimum rate of 6%, for one year beginning 15 November 2021. The legislation also sets dividend distribution ordering rules to trigger a pro rata distribution of trapped earnings, which applies to dividend distributions as of 15 August 2021. See **Tax Alert 2021-2225**, dated 10 December 2021.

Mexico — On 12 November 2021, Mexico enacted legislation changing how companies calculate their interest limitation under the thin-capitalization rules if they use the tax-equity option. Other changes include:

- Limiting certain benefits for non-regulated special purpose financial institutions (i.e., companies dedicated to financing activities and used to set up financing structures)
- Requiring Mexican companies to have a valid business purpose for restructurings, spin-offs and mergers to qualify as tax free
- Expanding the definition of back-to-back loans to include financing arrangements that lack business purpose (i.e., lack economic substance)
- Modifying the requirements nonresidents must satisfy to defer payment of income taxes on capital gains from a corporate reorganization
- Amending transfer pricing rules applicable to *maquiladoras* in connection with a permanent establishment (PE) exemption

The changes are generally effective 1 January 2022. See **Tax Alert 2021-1982**, dated 29 October 2021.

Poland — On 23 November 2021, Poland enacted legislation significantly reforming its corporate income tax. Changes include:

- Simplifying the requirements that Polish companies must satisfy to consolidate for income tax purposes
- Changing the calculation of the limit on deductions for financing costs
- Limiting deductions for certain intra-group financing costs, such as share acquisitions, equity contributions or buybacks of corporate stock
- Taxing so-called shifted profits (i.e., undertaxed payments) by applying a 19% corporate income tax rate in Poland on certain qualified payments made directly or indirectly to related entities if effective taxation is at least 25% lower than the 19% rate (additional tests and exceptions could apply)
- Limiting tax depreciation of certain real property by real estate-rich entities (i.e., entities that have Polish real estate as the majority of their assets and meet other requirements) to book depreciation

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* A Tax Alert has not been published on this development.

- Introducing new tax exemptions for Polish holding companies, including an income tax exemption for 95% of dividends received from qualified subsidiaries and a capital gains tax exemption for sales of stock in qualified subsidiaries, provided certain requirements are met
- Redefining "place of effective management" to prevent Polish companies from claiming to be headquartered in a foreign jurisdiction where they do not engage in actual business operations or prevent foreign companies headquartered elsewhere from being managed from Poland
- Allowing eligible companies that perform research and development (R&D) in Poland to deduct an additional 200% of their R&D-related employment costs
- Allowing companies to deduct an additional 50% of the costs of new industrial robots, the machines and peripheral devices needed to operate the robots, and the intangible assets needed to use these robots, such as related training services
- Allowing companies to deduct 30% of the costs of a new product's trial production and introduction to the market (up to 10% of operating income)
- Allowing companies to deduct up to PLN250k annually in costs from business expansion and consolidation

The changes are generally effective 1 January 2022. See Tax Alerts **2021-2124**, dated 19 November 2021, and **2021-2147**, dated 24 November 2021.

Turkey — On 26 October 2021, Turkey enacted legislation increasing the rate for notional interest deductions for cash contributions made from abroad to 75% from 50%. The legislation also accelerates amortization rates and periods for certain newly acquired machines and equipment until 31 December 2023. Other changes include exempting agricultural support payments (i.e., payments made by public institutions to support the agriculture industry and farmers) from withholding tax. The changes are effective upon enactment. See **Tax Alert 2021-2026**, dated 5 November 2021.

Other considerations

Court decisions, regulations issued by tax authorities and other events may constitute new information that could trigger a change in judgment in recognition, derecognition or measurement of a tax position. These events also may affect your current or deferred tax accounting.

Federal, state and territories

Federal — In a notice, the Government clarified that the temporary 100% deduction available to employers for 2021 and 2022 for food or beverages provided by a restaurant applies to the meal portion of per diem payments to employees traveling for business purposes. See **Tax Alert 2021-2104**, dated 17 November 2021.

In a separate notice, the US Government announced that it will again delay the effective date of temporary and final regulations under IRC Section 987 for an additional year. The regulations, which will take effect 1 January 2023 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 2021-1886**, dated 15 October 2021.

California — The Superior Court for the County of Los Angeles rejected a challenge to the constitutionality of the Clean Energy Jobs Act, which, among other things, mandated the use of a single sales factor (SSF) apportionment factor for California corporate franchise tax purposes. The Court found that the Act's provisions (i.e., the SSF mandate, a new fund to support clean energy jobs and a tax incentive for certain cable television providers) did not violate the single subject rule in California's Constitution. See the **State and Local Tax Weekly for 12 November 2021**.

Texas — The Government amended the requirements that companies must satisfy to claim credits for R&D activities under Texas franchise tax rules. The amendments are effective retroactively to Texas franchise tax reports originally due on or after 1 January 2014. See **Tax Alert 2021-1860**, dated 13 October 2021.

Tax amnesties

This table shows tax amnesties that were announced or went into effect in the fourth quarter of 2021.

Jurisdiction	Amnesty period	Taxes covered	Reference
Connecticut	1 November 2021–31 January 2022	Including, but not limited to, corporation business taxes for tax periods ending on or before 31 December 2020	**Tax Alert 2021-2047**, dated 9 November 2021

International

Argentina — In a decree, the Government extended until 31 December 2038 the expiration date of the promotional regime for industrial companies located in the Province of Tierra del Fuego, Antarctica and the Southern Atlantic Islands for companies that have industrial projects (e.g., manufacture televisions, cell phones or air conditioners) in progress as of 23 October 2021. The extension allows companies to continue to claim income tax exemptions, among other incentives. The promotional regime may be extended for another 15 years beginning 1 January 2039, if certain conditions are met. See **Tax Alert 2021-1974**, dated 28 October 2021.

Austria — In revised transfer pricing guidelines, the Government outlined the circumstances under which an employee's home office creates a PE for a foreign employer. See **Tax Alert 2021-2068**, dated 12 November 2021.

Colombia — In a decree, the Government outlined criteria for identifying a preferential tax regime (PTR) and the consequences for doing business with parties that are tax residents located or operating in a PTR. Withholding tax equal to the corporate rate (31% for 2021 and 35% for 2022) applies to payments made to companies in PTRs, unless a reduced rate applies under a tax treaty. Similarly, Colombia's transfer pricing regime applies to transactions between a Colombian company and a party in a PTR, even if the parties are not related. See **Tax Alert 2021-2010**, dated 3 November 2021.

European Union — The Council of the European Union (EU) updated Annex I of the EU list of noncooperative jurisdictions for tax purposes (the EU list), which identifies jurisdictions whose tax policies fail to meet EU standards by the required deadline. Annex I of the EU list now includes American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, the US Virgin Islands and Vanuatu. This follows the removal of Anguilla, Dominica and Seychelles.

The Council also updated Annex II of the EU list, which identifies jurisdictions that are making progress on reforming their tax policies but remain subject to close monitoring. Annex II now includes 15 jurisdictions: Anguilla, Barbados, Botswana, Costa Rica, Dominica, Hong Kong, Jamaica, Jordan, Malaysia, North Macedonia, Qatar, Seychelles, Thailand, Turkey and Uruguay. Australia, Eswatini and Maldives were removed, and Costa Rica, Hong Kong, Malaysia, North Macedonia, Qatar and Uruguay were added. See **Tax Alert 2021-1812**, dated 6 October 2021.

Germany — The Federal Fiscal Court (BFH) held that a German company could deduct interest payments on loans it received from an affiliated Dutch financing company, rejecting the tax authorities' position that the deductions should have been reduced because the affiliate did not control the financing risk. The BFH reasoned that the transaction should be based on the economic circumstances of the borrower, not the lender, and that certain intercompany lenders are not prohibited from making risk-free loans. See **Tax Alert 2021-1915**, dated 22 October 2021.

Separately, the Government announced that it extended its agreement with Austria regarding teleworkers until at least 31 December 2021. Under the agreement, employees working from their home office in their country of residence solely as a result of the pandemic will generally not create a home office PE for their foreign employers. See **Tax Alert 2021-2068**, dated 12 November 2021.

Italy — In a decree, the Government modified Italy's patent box regime by replacing the 50% tax exemption for income from intellectual property with a "super deduction." The new regime allows companies to deduct 190% of their qualifying R&D expenses (e.g., R&D-related expenses for copyrighted software, patents, trademarks, designs, models and qualifying know-how). R&D expenses incurred between related parties are not eligible for the deduction. Companies electing the new patent box regime may not claim Italy's R&D tax credit.

The decree is effective beginning 21 October 2021, but it must be approved by the Italian Parliament within 60 days to remain effective. See Tax Alerts **2021-1929**, dated 25 October 2021, and **2021-1962**, dated 28 October 2021.

Paraguay — In a general resolution, the Government established new rules for taxpayers to consider when performing a transfer pricing analysis. The resolution also clarifies when parties are considered related. See **Tax Alert 2021-1972**, dated 28 October 2021.

Peru — In a resolution, the Peruvian Tax Court established guidelines that companies must meet to qualify under the Peru-Chile income tax treaty as beneficial owners (i.e., companies that control the disposition of payments they receive, rather than funneling them to another company). Companies that do not qualify as beneficial owners must pay the higher Peruvian rate of withholding tax, rather than the lower treaty rate. See **Tax Alert 2021-1927**, dated 22 October 2021.

Spain — The EU Court of Justice held that Spain violated EU law by allowing Spanish companies to amortize certain financial goodwill for tax purposes when they acquired at least 5% of a foreign company. The Court agreed with the EU General Court that Spain's different treatment of the acquisition of Spanish and non-Spanish companies qualified as illegal state aid, even though it held that the lower court erred. See **Tax Alert 2021-1844**, dated 12 October 2021.

Uruguay — In a decree, the Government announced that exemptions from the corporate income tax and nonresident income tax apply retroactively from 21 April 2020 to income from leasing social-interest housing (i.e., low-income housing). See **Tax Alert 2021-1870**, dated 14 October 2021.

Things we have our eyes on

National, state and local governments continue to seek to increase their revenues. Companies should continue to monitor developments in this area. Some of these potential tax law changes are summarized here.

Federal, state and territories

Tax reform — The US House of Representatives passed the Build Back Better Act (HR 5376) reconciliation bill, which would significantly revise US income tax rules. Following passage of the House bill, Senate Finance Committee Chair Ron Wyden, D-Ore., released updated text of the bill's tax provisions. The updated text largely retains the proposals from the House bill but includes some significant technical changes. Proposals in the Senate Finance Committee version of the bill would:

- Introduce a 15% corporate alternative minimum tax based on book income for companies that report over $1 billion in profits to shareholders (excluding pension plans generally)
- Limit, under new IRC Section 163(n), the deductible interest expense of a multinational group's US operations to its proportionate share of the group's overall interest expense based on either an EBITDA ratio or its adjusted basis in assets
- Delay the effective date of mandatory capitalization of research and experimental expenditures to tax years beginning after 31 December 2025
- Change the rules for global intangible low-taxed income (GILTI) by:
  - Lowering the IRC Section 250 deduction percentage for GILTI to 28.5% from 50%, resulting in an effective GILTI tax rate of 15.02%
  - Requiring US shareholders to compute their GILTI inclusion on a country-by-country basis
  - Making other changes to the GILTI computation, such as including foreign oil and gas extraction income in GILTI-tested income, reducing the deemed tangible income return to 5% rather than 10% of qualified business asset investment and allowing tested losses to be carried forward
- Change the foreign tax credit (FTC) rules to:
  - Determine the FTC limitation for all categories on a country-by-country basis so companies could not credit excess FTCs from high-tax jurisdictions against income from low-tax jurisdictions
  - Repeal carryback of FTCs for all baskets and allow a temporary five-year carryforward period for GILTI FTCs (extended to 10 years for tax years beginning after 31 December 2030)
  - Eliminate the separate foreign branch basket for FTC limitation purposes
  - Increase a US corporation's deemed paid credit to 95% of foreign income taxes attributable to GILTI inclusions rather than 80% under current law
  - Limit US expenses treated as allocable to the GILTI basket to only directly allocable expenses
- Change the rules for foreign-derived intangible income (FDII) by:
  - Lowering the IRC Section 250 deduction percentage for FDII to 24.8% from 37.5%, yielding an effective FDII tax rate of 15.8%
  - Excluding from the computation of FDII certain passive income and gains from the sale or disposition of property that generated rents or royalties
- Removing the IRC Section 250 taxable income limitation for GILTI and FDII and allow the IRC Section 250 deduction to create an NOL when taxable income is less than the deduction
- Retain the general framework of the base erosion and anti-abuse tax (BEAT) but make significant changes, such as:
  - Accelerating the increases in the BEAT rates
  - Excepting certain amounts from treatment as base erosion payments if (1) US tax is imposed on that amount or (2) the amount is subject to a sufficient rate of foreign tax (i.e., the lesser of the applicable BEAT rate or 15%)
  - Treating certain inventory-related costs or payments as base erosion tax benefits

- Change the rules for the IRC Section 245A dividends-received deduction to:
  - Limit IRC Section 245A deductions on dividends from "specified 10%-owned foreign corporations" that are not controlled foreign corporations to 65% of dividends received
  - Deny a credit or deduction for foreign taxes paid or accrued with respect to the applicable percentage for which the dividends-received deduction is allowed
  - Expand the anti-inversion rules in IRC Section 7874 by reducing the applicable continuing ownership thresholds and expanding the types of acquisitions subject to these rules

As part of its spending package, the bill also includes numerous income tax credits for housing and clean energy. See Tax Alerts **2021-1956**, dated 27 October 2021; **2021-9026**, dated 29 October 2021; **2021-1990**, dated 1 November 2021; **2021-2040**, dated 8 November 2021; **2021-9027**, dated 19 November 2021; **2021-2130**, dated 22 November 2021; **2021-2139**, dated 23 November 2021; and **2021-2235**, dated 13 December 2021.

International

Austria — The Government proposed reducing the 25% corporate income tax rate to 24% in calendar year 2023 and to 23% in calendar year 2024. It also proposed reducing the 25% withholding tax rate on profit distributions to corporations to 24% as of 1 January 2023 and to 23% as of 1 January 2024. Other changes include:

- Taxing income and gains from cryptocurrency at a special rate of 27.5%, beginning 1 March 2022, for cryptocurrencies acquired after 28 February 2021
- Allowing companies to amortize an additional 10% of the acquisition or production costs of depreciable assets in the year of acquisition/production as an investment allowance (15% for ecological investments), beginning 1 January 2023, provided certain conditions are met
- Increasing the limit for immediate depreciation of low-value assets to €1,000 per asset from €800 for tax years beginning after 31 December 2022

See **Tax Alert 2021-2114**, dated 18 November 2021.

Hong Kong — In response to its placement on Annex II of the EU list, the Government pledged to amend its foreign-source income-exemption regime to prevent domestic companies with no substantial economic activity in Hong Kong from escaping taxation on offshore passive income, including interest and royalties. See **Tax Alert 2021-1818**, dated 7 October 2021.

Ireland — In Finance Bill 2021, among other items, the Government proposes to attribute income to a branch of a nonresident company operating in Ireland as if the branch earned the income at arm's length as a separate entity. The approach, known as the "Authorised OECD Approach" (i.e., Organisaton for Economic Co-operation and Development), would apply to a branch or agency through which a nonresident company carries on a trade in Ireland. See **Tax Alert 2021-2068**, dated 12 November 2021.

Italy — In a draft circular, the Government outlined its interpretation of Italy's hybrid mismatch rules, which were enacted when Italy adopted the EU's anti-tax avoidance directive. Topics addressed in the circular include:

- Taxes to which the hybrid mismatch rules apply
- The rules' effective dates
- Circumstances in which the rules do and do not apply
- How and when to address a hybrid mismatch

See **Tax Alert 2021-2136**, dated 23 November 2021.

OECD — In a statement dated 8 October 2021, the Inclusive Framework of the Base Erosion and Profit Shifting project announced that 136 of its 140 member jurisdictions reached a global tax agreement. The member jurisdictions agreed that certain multinational companies must reallocate 25% of their residual profits to market jurisdictions under revised rules for nexus and profit allocation. They also agreed on a 15% global minimum tax, along with other thresholds, rates and administrative mechanisms.

On Pillar Two and the global minimum tax, model legislation and commentary were targeted to be completed by the end of November 2021. The text of a Multilateral Convention and the model rules for domestic legislation necessary for the implementation of Pillar One are expected in early 2022.

In a separate statement, Ireland announced its support for the agreement following assurances that its 12.5% corporate rate would remain intact for companies with annual revenue below €750 million, and the global minimum tax would be 15%, instead of "at least" 15%, as previously proposed. Similarly, Hong Kong reiterated its intent to implement the agreement.

In a 13 October 2021 communiqué, the G20 Finance Ministers and Central Bank Governors endorsed the agreement and urged the Inclusive Framework to develop model rules and treaties that could be adopted in 2023.

See Tax Alerts 2021-1830, dated 8 October 2021; 2021-1839, dated 8 October 2021; 2021-1840, dated 11 October 2021; 2021-1877, dated 15 October 2021; and 2021-1905, dated 20 October 2021.

Peru — The President asked Congress for the power to enact various tax measures without legislative approval. If Congress grants the request, the President could enact provisions that would do the following:

- Modify the rules for deducting expenses and costs for purposes of determining the corporate income tax
- Tax dividend distributions between Peruvian corporations
- Modify the rates applicable to nonresidents for international activities performed partially in Peru and partially abroad
- Modify the fair market value rules applicable to securities
- Limiting the deductibility of payments that are effectively mining royalties

See **Tax Alert 2021-2000**, dated 2 November 2021.

United Kingdom — In its second budget of fiscal year 2021, the Government proposed broadening the scope of expenses for which companies may claim the R&D credit to include data and cloud computing costs, effective April 2023. From that date, companies would also face restrictions on claiming the credit for R&D conducted overseas. Other proposals include:

- Extending the expiration date of the £1m cap on certain accelerated amortization by 15 months to 31 March 2023
- Prohibiting UK companies from offsetting their income with losses incurred by related companies in the European Economic Area (EEA)
- Limiting the losses that EEA companies may use to offset income from their UK PE
- Prohibiting companies in financial distress from carrying forward losses to offset profits from lease renegotiations
- Simplifying the requirements that a company or group must meet to qualify as a real estate investment trust
- Granting tax incentives, such as reduced corporate income tax and increased amortization allowances, to businesses that begin operating in freeport tax sites (i.e., special economic zones with tax incentives to help stimulate regional growth) in November 2021 or afterward
- Treating certain noncorporate entities as partnerships for purposes of the UK hybrid mismatch rules, as previously promised
- Introducing a new tax regime benefiting UK asset holding companies

See Tax Alerts 2021-1971, dated 28 October 2021, and 2021-2113, dated 18 November 2021.

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