January 17, 2020

2020 Tax Legislative and Regulatory Outlook

As Congress returned to Washington this month, its immediate focus was on impeachment proceedings in the Senate, passage of the United States-Mexico-Canada Agreement (USMCA), trade relations with China and the European Union, and a potentially volatile situation in the Middle East. The legislative calendar in 2020 will be compressed as a result of the political conventions in the summer and to allow for campaigning in the months leading up to the Presidential and Congressional elections in November. Despite these challenges, there are a number of reasons to believe that 2020 could turn out to be a busy and productive tax year for tax policy:

- A number of issues – most notably technical corrections, refundable tax credits, renewable energy incentives, and multiemployer pension funding - were part of the 2019 year-end negotiations, but ultimately were excluded from the December tax deal. Both sides are expected to continue to advance their priorities early this year and the year-end negotiations could serve as the basis for compromise legislation in 2020.
- Republicans and Democrats have expressed a desire to address a number of important policy issues, such as high prescription drug costs, surprise medical billing, and infrastructure. There could be a push to pursue these and other priorities early in 2020, particularly in the House, because they address matters that are key political issues in a number of congressional districts. While these items are not all tax bills, any of them could be vehicles for tax legislation.
- There are a number of legislative deadlines that could provide the impetus for tax legislation, including health extenders expiring on May 22, current appropriations bills and Highway Trust Fund reauthorization expiring on September 30, and 33 tax provisions expiring on December 31.
- Any tax legislation left unresolved before the November elections could be addressed in a lame duck session. The exact agenda for the lame duck will depend on a number of factors, including whether there is any must-do legislation outstanding (e.g., government funding), whether there will be a new Administration in the White House, whether there is a shift in majorities in the House and/or the Senate, and whether there is a general desire to "clear the decks" and complete tax legislation before the start of the 117th Congress.

Even if a particular tax legislative issue does not make it over the finish line in 2020, the work that Congress does this year will lay the groundwork for legislative efforts in 2021. The first year after a Presidential election generally is very busy, as the Administration and Congress seek to implement a number of their policy priorities.

On the regulatory side, the Treasury Department and the Internal Revenue Service (IRS) continue their focus on issuing regulations to implement the Tax Cuts and Jobs Act (TCJA).

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Treasury Assistant Secretary for Tax Policy David Kautter has said that the government's "ambitious goal" is to release guidance on every TCJA-related provision by Fall 2020.

There also will be a significant amount of attention by U.S. policymakers on international tax activity, as the Organization for Economic Co-operation and Development (OECD) seeks to achieve in 2020 worldwide consensus addressing the tax challenges arising from the digital economy.

Our outlook for tax legislation and regulatory efforts in 2020 is divided into several sections:[1]

(1) a tax legislative outlook;
(2) a tax regulatory outlook;
(3) a detailed discussion of the backdrop to, and the current status of, OECD efforts regarding the digital economy; and
(4) a brief discussion of Presidential campaign issues.

Legislative Outlook

Fiscal Year 2020 Appropriations Package

At the end of 2019, Congress passed two combined appropriations bills that would fund the entire government through the 2020 fiscal year, which ends September 30, 2020.[2] As part of those negotiations, Congressional leaders reached an agreement on a tax title with mostly bipartisan, less contentious tax policies. The enacted tax package had four principal components, as well as a few discrete changes to the TCJA.

1. Repeal of the Affordable Care Act (ACA) taxes – The largest items in the year-end package were the permanent repeal of the medical device excise tax, Cadillac tax, and health insurance tax, collectively referred to as the "ACA taxes," which collectively represented over $373 billion of the total $427 billion in estimated reduced revenues over ten years.

2. Extension of expiring and expired provisions – The package extended 35 provisions that had expired in 2017 or 2018, or were set to expire in 2019. All of those provisions were extended through the end of 2020, except that the short-line railroad maintenance provision and the biodiesel and renewable diesel credits were extended through the end of 2022.[3] The extension of these provisions collectively were estimated to reduce revenues by roughly $40 billion over ten years. Not all Members of Congress were happy with another temporary extension of expiring provisions. House Ways and Means Ranking Member Kevin Brady (R-TX), for example, tweeted before the final deal was

[1] There are several supplemental documents to this outlook. They include (1) a comprehensive overview of expiring provisions in the tax code; (2) a list of key dates to watch in 2020; (3) an overview of the status of outstanding regulations related to TCJA; and (4) a comparison of selected Democratic Presidential candidates.
[2] FY2020 Consolidated Appropriations Act (H.R. 1158) and FY2020 Further Consolidated Appropriations Act (H.R. 1865).
[3] See the attached chart for a comprehensive overview of expiring tax provisions extended by the FY2020 Further Consolidated Appropriations Act.

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announced that the deal was "business as usual" and that the "fight isn't over – yearly temp tax circus needs to end."

3. Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 - The December bill also included the SECURE Act, a wide array of retirement plan changes aimed at expanding access to retirement savings and expanding portability of savings. Proponents of the SECURE Act, including House Ways and Means Committee Chairman Richard Neal (D-MA) and Sen. Rob Portman (R-OH) have viewed passage of that bill as precursor to passage of further legislation expanding retirement savings incentives. The SECURE Act was mostly offset though a revenue raiser tightening rules on inherited IRAs by non-spouse beneficiaries (i.e., so-called "stretch IRAs"). The SECURE Act was estimated to reduce revenues by about $500 million over ten years.

4. Disaster tax relief – The December bill removes certain limitations on the use of retirement funds and the deduction of personal casualty losses for taxpayers in disaster areas. One notable item in the disaster relief tax title is a change to the excise tax on private foundations. Private foundations are now subject to a single excise tax rate of 1.39 percent, regardless of whether the foundation makes significant payments to charities on their net investment earnings or not.[4] Disaster tax relief was estimated to reduce revenues by roughly $13 billion over ten years.

Three changes to the TCJA were also included in the December bill, including (i) repeal of the so-called "church parking tax" that required charities to pay unrelated business income tax on certain fringe benefits provided to employees, (ii) a fix regarding the treatment of certain grants received by tax-exempt telephone or electric cooperatives, and (iii) a provision to repeal the "kiddie tax" glitch for Gold Star families and others, which taxed children's unearned income at the rates applicable to trusts instead of their parents' income tax rate.[5]

Unfinished Items

An even larger package of more controversial items that included a trade of TCJA technical corrections (sought by Republicans) in exchange for refundable credit expansions and/or renewable energy provisions (sought by Democrats) seemed possible leading into the final weekend of negotiations. Although it was not clear how close Congressional negotiators were on a deal, according to press reports the White House weighed in during the final moments and objected to the expansion of refundable tax credits and the expansion of the electric vehicle tax credit. Consequently, these items were not included in the final package, but are likely to remain as priorities respectively for both sides, as we head into 2020.

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[4] Previously, private foundations were subject to a 2 percent tax on net investment income, but the rate could be reduced to 1 percent if the foundation exceeded its average payout rate by a specified amount determined under a complex formula. The new 1.39 percent rate was adopted because it was revenue neutral.

[5] These changes were not "technical corrections" and had a revenue impact. The "kiddie tax change" was included in the SECURE Act component of the bill and was estimated to reduce revenues by $470 million over ten years. The other two were estimated to reduce revenues by a combined $1.9 billion over ten years.

In addition, the Ways and Means Committee also marked up several pieces of legislation, including an excise tax on vaping products and a bill reinstating the state and local tax (SALT) deduction, that could resurface this year.

In addition to the unfinished tax items, Members will likely continue to push to include multiemployer pension reform and drug pricing bills in any legislative vehicles moving forward. Both of these bills fall within the tax-writing committees' jurisdictions and have tax titles associated with the bills.

Legislative Deadlines

Entering into a contentious election year with a compressed congressional calendar, the passage of additional tax legislation in 2020 is possible but will be challenging. The House and Senate are scheduled to be in town together for only 98 legislative days this year. Additionally, there are relatively few significant legislative deadlines that could affect the timing of tax legislation. Unlike in past years with the prospect of a debt ceiling crisis, a government shutdown or a looming tax increase, 2020 has fewer action-forcing deadlines. The two-year bipartisan budget deal signed in August 2019, pushed the debt ceiling and discretionary spending issues beyond the 2020 elections and into 2021.

Last year, Congressional leaders manufactured an action-forcing deadline when they temporarily extended a series of healthcare policies through May 22, 2020. This deadline is intended to trigger legislative action this spring to address surprise billing and drug pricing issues. Failure to take action in May would allow major healthcare program funding to lapse or be significantly reduced. Tax items could become part of these negotiations either as integral to the healthcare provisions themselves or because lawmakers view this package as an appropriate legislative vehicle for other tax priorities.

Another significant deadline involves highway funding in the Fixing America's Surface Transportation Act of 2015 (FAST Act), which expires on September 30th. Although the Senate Environment and Public Works Committee marked up a five-year reauthorization measure last July, the other Senate committees with jurisdiction (i.e., Commerce, Finance, and Banking) have not made much progress. On the House side, the Transportation and Infrastructure Committee and the Ways and Means Committee are likely to develop their own version of the surface transportation reauthorization in 2020. Infrastructure has consistently been thought of as an area where the Administration and Congressional Democrats might be able to work together. Whether or not lawmakers and the Administration can agree on a long-term infrastructure deal remains uncertain, but possible. Should a compromise infrastructure package be achieved, it could serve as a vehicle for other tax measures. Either way, lawmakers must act on the September 30 deadline, even if only to approve a short-term authorization of expenditures from the trust fund until the next Congress.

By extending most of the expiring and expired provisions only through the end of 2020, Congress will soon face another deadline upon which politically popular provisions will expire

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without Congressional action.[6] Their expiration may provoke action by lawmakers to revisit last year's negotiation on tax extenders. Technical corrections to the TCJA, refundable tax credits, and renewable energy incentives could be part of any end of the year negotiations. Moreover, the list will likely expand to include other bipartisan, and in some cases bicameral tax legislation that has been developed and readied for consideration. This most likely would occur during the expected lame-duck session. But unlike last December, the 116th Congress is coming to a close so there could be additional pressure to come to resolution on these matters.

The 2020 expiring provisions outlook may be complicated by business provisions related to the TCJA that will enter into force after the end of 2021, including the amortization of research and experimental expenditures and the provision changing the determination of the business interest limitation under section 163(j) based on earnings before interest, tax, depreciation, and amortization (EBITDA) to one based solely on earnings before interest and tax (EBIT). Because of the size of the these expiring provisions and their importance to relevant stakeholders, it is likely there will be significant efforts to have these items included in any end-of-year extenders conversation.

Below are significant dates to note:[7]

February 4 – State of the Union Address
March 3 – Super Tuesday Primaries
May 22 – Expiration of Healthcare Extenders
July 13-16 – Democratic Convention – Milwaukee, WI
August 24-27 – Republican Convention – Charlotte, NC
September 30 – End of Fiscal Year, Highway Trust Fund Authorization Expires
November 3 – Election Day
November 9 – Start of Lame Duck Session
December 18 – Target Adjournment Date
December 31 – Tax Extenders, Miners Act, and Craft Beverage Modernization Expire

Ways and Means Committee Outlook

Looking ahead to the 2020 schedule for the Ways and Means Committee, Chairman Neal has prioritized pursuing an infrastructure bill. He has raised this issue frequently during the past year with Treasury Secretary Steven Mnuchin and tried to secure an agreement that the Administration will support Congressional efforts to pursue an infrastructure package after completion of the USMCA trade bill. Despite Chairman Neal's entreaties, it is not clear at this time whether Treasury Secretary Mnuchin or other Administration officials will agree to participate in these efforts, or whether the Republicans on the Committee will also be involved in drafting or supporting this bill.

During January, Committee staff will be meeting with the tax aides for the Democratic Ways and Means Committee member offices to solicit ideas for an infrastructure bill. Chairman Neal has

[6] Note that the expiring provisions include certain excise taxes, such as provisions reducing tax rates on beer, wine, and distilled spirits, which will be imposed in January 2020 if not extended.
[7] See attached chart for a comprehensive list of important dates in 2020.

indicated that he believes this bill should be broad and encompass more than just funding for roads, bridges, and transit, to include, for example, housing or broadband policies. After these meetings, the Committee staff will try to fold these ideas, and possibly some from non-Committee Members or from Republican Members, into a discussion draft, similar to the process with the "green energy" package released by Select Revenue Measures Subcommittee Chairman Mike Thompson (D-CA) in November.

Whether (and how) the infrastructure package will be offset is unanswered for now; that may be decided later when the outlook for this bill becomes more certain. On January 16, 2020, House Speaker Nancy Pelosi (D-CA) said she intends to roll out an infrastructure package during the last week of January. The rollout will likely coordinate efforts by House Transportation and Infrastructure Committee Chairman Peter DeFazio (D-OR) on his infrastructure bill and the Ways and Means Committee. Chairman DeFazio must meet a September 30th deadline for reauthorization of surface transportation funding (a version already passed a Senate Committee last summer), but says he hopes to produce a bill broader than a simple highway reauthorization.

We understand the full Ways and Means Committee may hold a hearing as early as January on infrastructure funding and financing issues. Later, hearings in Select Revenue Measures and other relevant subcommittees may be held on narrower topics. Bill introduction is expected later in the Spring, but it is not clear yet if it will be marked up in the Committee.

It is also expected that the full Committee will hold more tax hearings this year, including a long-anticipated international tax hearing and perhaps a hearing to review issues and concerns with the TCJA. Since its enactment into law, a number of technical corrections and policy reversals have been proposed, without receiving much Committee discussion or review.

The Committee may also mark up tax administration legislation leading up to tax filing day, April 15, 2020. Last year, a larger effort to update tax administration, the Taxpayer First Act, was enacted, but we do not expect a bill as comprehensive this year.

Chairman Neal also has prioritized bringing an earned income tax credit (EITC) and child tax credit (CTC) expansion bill to the House floor. H.R. 3300, the Economic Mobility Act, which passed the Committee last year and was part of the year-end negotiation with the Senate and the White House, was not included in the final package due to White House and Republican objections. The Committee-passed bill did not contain revenue offsets to pay for the estimated $101 billion cost of the bill. Many senior House Democrats have stated they will not allow any tax technical corrections to the TCJA without Republicans allowing some or all of these refundable tax credit provisions to pass as well. Nevertheless, passage of the EITC and CTC bill in the House could be viewed by House Democrats as strengthening their position in any tax bill negotiation.

The Ways and Means "green energy" package released as a discussion draft by Subcommittee Chairman Thompson was a compilation of Members' proposals designed to spur additional comments and suggestions. It is possible that we will see another version of this bill, and perhaps, Committee or House floor action on that modified proposal.

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Finally, a lingering policy for Chairman Neal is the Rehabilitation for Multiemployer Pensions Act, also known as the Butch Lewis Act (H.R. 397), to address the long-term solvency of certain multi-employer pension plans. He previously had suggested this bill could be a potential "sweetener" on the USMCA trade bill, since many unions support the Butch Lewis Act, but were lukewarm on the trade bill. Ultimately, USMCA passed the House without needing to add the Butch Lewis Act to attract union support. Because the Butch Lewis Act has already passed the House, the next action on multiemployer issues may be in the Senate.

Chairman Neal has stressed the need for a multilateral approach to addressing the concerns regarding digitalization of the global economy. He said in a September 25, 2019 letter to Treasury Secretary Mnuchin and United States Trade Representative Lighthizer that, "A unilateral approach… does nothing to advance the purposed goal of these unilateral taxes: a lasting change to our tax rules that reflects the digitalization of the economy. Tax legislation passed due to political pressure, without vetting or consensus, results in unintended consequences and hurts taxpayers. A consensus-based approach aimed at reaching measured and comprehensive solutions is more responsible and much more preferable."

Neal indicated that the Ways and Means Committee would continue its oversight of this issue, requesting that Treasury and USTR keep him and his Ways and Means colleagues timely and closely apprised of their progress and developments in this area.

Senate Finance Committee Outlook

The Senate Finance Committee held just a few tax hearings in 2019; the agenda for 2020 is focused on trade- and healthcare-related issues. At this time, there are no planned tax hearings or markups.

Senate Finance Committee Chairman Charles Grassley (R-IA) said on January 10 that his tax priorities for 2020 will continue to be permanency of the 2017 tax law and adoption of tax technical corrections. He said in a statement, "As chairman of the tax-writing Senate Finance Committee, I'll continue to advance efforts to make the 2017 tax reform permanent and correct technical errors in the bill so individuals, farmers, and small businesses enjoy the full benefit of the new tax law. We'll also pursue other priorities that we began last year, such as retirement and pension reform, building on the passage of the Setting Every Community Up for Retirement Enhancement (SECURE) Act and helping ensure that multiemployer pension plans like Central States can provide retirement benefits over the long term."

Late last year Chairman Grassley and Senate Health, Education, and Labor and Pensions (HELP) Committee Chair Lamar Alexander (R-TN) released a proposal to address the multiemployer pension shortfall issues.[8] As noted above, this is an issue that the House is actively working on too, so it is possible that Finance may take up a pension bill this year. The Multiemployer Recapitalization and Reform Plan released by Chairmen Grassley and Alexander in November 2019 includes numerous proposals to address plan underfunding, including increasing Pension

[8] Multiemployer Pension Recapitalization and Reform Plan Whitepaper (Nov. 20, 2019), https://www.finance.senate.gov/imo/media/doc/2019-11-20 Multiemployer Pension Recapitalization and Reform Plan White Paper.pdf

Benefit Guaranty Corporation premiums, providing for partition of unhealthy plans, and permitting the use of new composite plans.

In addition, Finance is actively investigating the abuse of the conservation easement charitable contribution tax deduction. Chairman Grassley and Ranking Member Ron Wyden (D-OR) initiated an investigation on March 27, 2019, and we anticipate a report or potential oversight hearings in 2020 detailing the findings of the bipartisan investigation.

On his general role as "taxpayer watchdog," Chairman Grassley said that his oversight efforts will "work to uphold the integrity of federal tax laws and strengthen accountability at the IRS, including sharpening the effectiveness of the IRS whistleblower protection program to hold tax cheats accountable and restore even more revenue to the federal treasury." He said that he has stepped up his oversight of nonprofit hospital systems to ensure that they are fulfilling their charitable care obligations, and is continuing his investigations of "unlawful tax avoidance schemes that cheat the taxpaying public and erode voluntary compliance."

As with the Ways and Means Committee, we also anticipate that Finance will continue to engage both publicly and privately on the various OECD-related issues described in more detail below. Chairman Grassley and Sen. Wyden said in a December 2 joint statement on USTR's investigation into France's DST, "the French digital services tax is unreasonable, protectionist and discriminatory. Taking premature action that will adversely and disproportionately affect another OECD member state is contrary to the organization's goals and shouldn't stand."

Finally, it has been widely reported that the Committee Republicans are eager to advance the technical corrections process. To date, Ways and Means Ranking Member Brady is the only member to release a discussion draft proposal on the scope of technical and clerical corrections to the TCJA.[9] Since then, many individual technical corrections have been introduced as stand-alone legislation, and new or modified technical corrections have been identified by committee and Treasury staff. As a result, we anticipate that Finance Republicans will pursue releasing a new technical corrections discussion draft, or formal introduction of legislation, sometime in 2020, potentially on a bipartisan or at least bicameral basis (with House Committee Republicans).

As discussed above, Republicans pressed for inclusion of technical corrections as part of the December year-end package, but Democrats insisted on an exchange of expansions to the CTC and EITC. All indications are that Democrats have not backed off of their demands. Chairman Grassley, however, has stated that exchanging technical corrections for an expansion of refundables doesn't "fly in the Senate among Republicans, particularly in the leadership." Ranking Member Wyden said on December 17, "Democrats have long said that Republicans need to negotiate on broader issues if they want to fix all of the mistakes in their tax giveaway. Republicans knew about these major errors at the time, but plowed ahead despite Democratic warnings. Unfortunately, they refused to meet us halfway and agree to changes that would help working families make ends meet." This leaves the status of technical corrections being enacted

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[9] Tax Technical and Clerical Corrections Act Discussion Drat (Jan. 2, 2019), https://republicans-waysandmeansforms.house.gov/uploadedfiles/tax_technical_and_clerical_corrections_act_discussion_draft.pdf

in 2020 uncertain, even though it remains a top legislative tax priority of Finance Committee Republicans.

In September 2019, Sen. Wyden released a white paper to repeal the preferential rates for capital gains and dividends, impose taxes annually on the appreciation of certain "tradable" assets held by high-income or wealthy individuals (i.e., "mark-to-market"), and apply a lookback rule to appreciation in non-tradable assets to reduce incentives to defer tax.[10] Wyden has been soliciting feedback on his proposal and expects to continue working toward potentially releasing legislative text. Earlier in 2019, he introduced the Ending the Carried Interest Loophole Act, which would in part convert certain capital gains earned by investment fund managers to ordinary income. Sen. Wyden's work on these items could serve as a marker after the 2020 election if Democrats win the White House or Senate.

Tax Committee Changes

The makeup of the tax writing committees will remain largely unchanged in the second session of the 116th Congress, with the exception of one change on the Finance Committee. Sen. Ben Sasse (R-NE) has filled the Finance Committee vacancy that was created following the retirement of Sen. Johnny Isakson (R-GA) at the end of 2019. Sen. Sasse also serves on the Intelligence, Judiciary, and Banking committees. He is the first Nebraska Republican to serve on the Senate Finance Committee since the 1970s.

The tax committee membership will undergo numerous changes in 2021, however, due to several Member retirements and also possibly the results of the November elections. The following are changes which have been announced:

<u>Ways and Means Committee</u>

GOP members Reps. Kenny Marchant (TX) and George Holding (NC) have announced that they will not seek reelection. Rep. Kevin Brady (R-TX) is expected continue to serve as the Committee's Republican leader through the end of the 117th Congress (he was appointed in November 2015). Even though GOP rules approved in 1995 set a six-year term limit for chairpersons or ranking members, in 2019 the House Steering Committee passed a rule that excluded any half terms from the six-year term limit. President Donald Trump has tweeted about the need to extend the six-year term limit for GOP committee leaders.

<u>Finance Committee</u>

On the Senate side, Chairman Grassley will reach his term limit as the Republican committee leader at the end of this year. Sen. Mike Crapo (R-ID) is next in line in seniority. Two Finance Committee Members have announced they are retiring from the Senate at the end of 2020: Sen. Mike Enzi (R-WY) and Sen. Pat Roberts (R-KS).

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[10] Treat Wealth Like Wages (September 12, 2019), https://www.finance.senate.gov/imo/media/doc/Treat%20Wealth%20Like%20Wages%20RM%20Wyden.pdf.

Surface Transportation Reauthorization

The FAST Act authorized federal spending on highways and public transportation for FY 2016-2020 and expires on September 30, 2020.[11]

Mindful of the impending expiration of the FAST Act's authorization, the Senate Environment and Public Works Committee unanimously reported the America's Transportation Infrastructure Act of 2019 (ATIA, S. 2302) in July 2019. ATIA would authorize an additional $37.9 billion of spending from the highway account of the highway trust fund (HTF) for FY2021-2025, thus widening this shortfall. Other Senate committees of jurisdiction, including the Senate Finance Committee, which has jurisdiction over the funding of the HTF, have not yet acted on reauthorization legislation.

The House Transportation and Infrastructure Committee Chairman DeFazio has stated his intention to consider his highway reauthorization legislation in early 2020. As in the Senate, the authorizing committee does not have jurisdiction over HTF funding, which is within the Ways and Means Committee jurisdiction.

Last year, there was some optimism that a bipartisan consensus could be achieved with the Trump Administration to pass a large infrastructure bill that would have likely included a long-term extension of the highway and transit funding programs. These negotiations quickly fell apart, in part, due to differences as to funding the shortfall between authorized spending amounts and the revenue funding of the HTF.

Aside from a continuation of transfers from Treasury general funds to the HTF, the following is a partial list of possible revenue-raising options:[12]

- Increasing/indexing the fuel tax. If the motor fuel taxes for gasoline and diesel had been adjusted in 2018 to keep pace with the Bureau of Labor Statistics consumer price index since 1993, the 18.3-cents-per gallon gasoline tax would now be 31.8 cents per gallon

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[11] Historically, all of the federal highway program and 80 percent of the public transportation program have been funded with revenues from the Highway Trust Fund (HTF). Revenues supporting the HTF come from a combination of fuel, truck, and tire taxes, with the fuel taxes providing about 85-90 percent of the money.

The excise taxes on gasoline and diesel are fixed in terms of cents per gallon (18.3 cents per gallon for gasoline and 24.3 for diesel) and are not adjusted for inflation. The excise taxes on gasoline and diesel will decrease to 4.3 cents per gallon after September 30, 2022, unless Congress passes legislation to prevent the tax from decreasing. These rates were last raised in 1993. Increases in fuel consumption kept revenues growing until the recession that began in 2007. Since that time, improving fuel efficiency and slower growth in vehicle mileage have led revenue to level off in most years while spending from the HTF has consistently outpaced HTF revenues.

In 2008, Congress began providing transfers from the Treasury general fund to the HTF to prevent its insolvency. In the short term, the Congressional Budget Office (CBO) estimates that the HTF has sufficient balances to cover expected outlays through September 2021. In the long term, CBO estimates that additional revenue will be needed to continue the highway and public transportation programs at or above their current levels. Based on CBO estimates, a future reauthorization bill would need to cover a projected $19 billion/year annual shortfall.

[12] These options are compiled from resources produced by the Congressional Research Service, Congressional Budget Office, and Joint Committee on Taxation.

and the 24.3-cents per gallon diesel tax would be 42.2 cents per gallon. A one cent-per-gallon increase in the fuel taxes generates approximately $1.7-1.8 billion/year in additional HTF.

- Tax electric vehicles (EVs). Charging EV drivers for road use would provide some revenue and address the policy concern of these vehicles' current lack of contribution to the HTF.

- Federal sales tax on motor fuel. Imposing a federal tax on some percentage of the retail price of fuel either alongside or in place of a fixed cents-per-gallon tax (as has been used by some states). This is subject to wide fluctuations in times of retail price changes.

- Expanded use of tolling. Tolls could be used to pay for highway projects but are often expensive to administer and enforce and subject to evasion.

- Private investment. Increased use of public-private partnerships and privatization of roads and bridges may reduce federal costs in some cases.

- Asset recycling. The sale or lease to the private sector of government-owned infrastructure assets and the investment of the proceeds in new infrastructure was included in a draft bill circulated by former House Transportation and Infrastructure Committee Chairman Bill Shuster (R-PA) in 2018.

- Vehicle miles traveled tax (VMT). A tax based on mileage driven that may possibly replace the federal gas tax. Some VMTs have been tested at the state level, but concerns remain with privacy, administrability, implementation, collection costs, and distributional effects.

As lawmakers embark on this year's legislative agenda, a critical question will be whether agreement can be found among these or other revenue-raising option and a long-term extension passed or whether Congress defaults to a short-term extension of the current FAST Act (perhaps with some minor modifications) in light of sufficient HTF account balance through FY 2021. Notwithstanding the wiggle room afforded by a sufficient HTF account balance in 2020, we expect committee hearings and mark-ups (most likely, in the House Transportation and Infrastructure Committee and House Ways and Means Committee) as lawmakers lay the groundwork for a comprehensive reauthorization of the Highway and Transit Funding Programs.

Energy Outlook

Other than the extension of expired and expiring provisions in the year-end spending bill, legislation in 2019 did not address energy tax provisions. The 2019 extensions applied to credits for biodiesel and renewable diesel production, the second-generation biofuel producers, nonbusiness energy property, qualified fuel cell motor vehicles, the alternative fuel refueling property, two-wheeled plug-in vehicles, Indian coal production, electricity generated from renewable sources, energy-efficient homes, and alternative fuels. The special cost recovery deductions for second generation biofuel plants and energy efficient commercial building

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property were also extended, as was the ability to rollover gain from dispositions of certain electric transmission property and the tax rate applicable to the Oil Spill Liability Trust Fund.

These provisions generally were extended through 2020, with the credits for biodiesel and renewable diesel extended through 2022. Thus, Congress may need to address the extensions again in 2020, perhaps in a year-end, lame duck bill. Congress modified some of these provisions in 2019. The types of alternative fuels that qualified for credits was reduced, and the production tax credit (PTC) rate for electricity produced from wind power was increased from the 2019 rate. Congress may again decide to make policy modifications to these provisions when it next addresses the extensions.

Several other energy tax provisions reportedly were discussed in the negotiations for the year-end tax bill, but ultimately were not included in the final package. These provisions included expansion of the tax credit for electric vehicles, and the creation of investment tax credits (ITCs) for energy storage and offshore wind facilities. These provisions were also included in the GREEN Act, a discussion draft bill introduced by Democratic Members of the Ways and Means Committee in November. Many of the provisions in the GREEN Act were introduced as separate bills in the House and the Senate. Items in the GREEN Act included:

1. A five-year extension of the production tax credit for electricity produced from renewable sources and the investment tax credit applicable to solar facilities;
2. A 30 percent ITC for offshore wind facilities (through the later of 2024 or when 3,000 MW are installed);
3. An election to make credits refundable, with a 15 percent haircut;
4. Publicly traded partnership eligibility for income from renewable projects;
5. Extension and modification of the electric vehicle credit;
6. Various tax incentives for energy efficient property used in residences and businesses;
7. Extensions of the credits for renewable fuels;
8. Another round of advanced energy project credits (sec. 48C);
9. An environmental justice program credit; and
10. A Treasury study on greenhouse gas data for purposes of determining a fee on such.

Revenue offsets for the cost of these items were intended to be released but not disclosed.

We expect the Ways and Means Committee to continue to take comments on these items and mark up a bill in 2020. Whether any of these provisions become law in 2020 is unclear. An energy tax bill most likely cannot move as stand-alone legislation. Typically, energy tax provisions move as a title to a larger tax bill (such as a tax extenders bill) or a broader energy bill. The prospects for such legislation is unclear. Energy tax provisions could also be part of a larger infrastructure bill. Senate Minority Leader Chuck Schumer (D-NY) sent a letter to the President insisting on the inclusion of clean energy tax provisions on any infrastructure legislation, and over 160 Democratic House Members sent a letter to House leadership in support of such provisions. As discussed above, Chairman Neal has indicated that he would like the Ways and Means Committee to address infrastructure early in 2020.

We also expect to continue to see broader energy tax policy legislation introduced this year. In 2019, several carbon tax bills were introduced in both bodies, including some on a bipartisan basis. In May, Senate Finance Committee Ranking Member Wyden and 25 other Senate Democrats reintroduced the "Clean Energy for America Act" that would consolidate 44 current energy tax provisions into three technology-neutral provisions to promote energy independence and a low-carbon economy. This month, Ways and Means Committee Members Tom Reed (R-NY), Darin LaHood (R-IL), David Schweikert (R-AZ), Jimmy Panetta (D-CA) and Tom Suozzi (D-NY) reintroduced the "Energy Sector Innovation Credit Act," which would provide tax credits for innovation in emerging energy technologies.

Although the outlook for an energy tax bill to become law is murky, Treasury and the IRS have had several energy projects on their Priority Guidance Plan that could become public this year. The items include:

1. Final regulations for nuclear decommissioning funds (currently at OMB);
2. Guidance and proposed regulations relating to carbon oxide capture (expected early in 2020);
3. A revenue procedure dealing with the capitalization of natural gas transmission and distribution property;
4. Normalization requirements for regulated public utilities;
5. Definition of qualified property with respect to a solar facility; and
6. Guidance updating bond private use rules relating to public power.

Energy companies also should have an interest in more general guidance planned by Treasury and the IRS in 2020, including final regulations on interest disallowance under section 163(j), (currently at OMB), expensing under the section 168(k), and basis adjustments under section 50(b).

Outlook for Federal-State Tax Issues

A major federal policy change that impacted the states was the Supreme Court's decision in *South Dakota v. Wayfair*. In reaction to *Wayfair's* elimination of the physical presence requirement for collecting taxes on out-of-state Internet and catalogue sales, states acted quickly in 43 of the 45 states with sales taxes to require sellers without any physical presence to collect and remit sales taxes in such states. In addition, 38 states also implemented new tax rules requiring marketplace facilitators (companies that facilitate sales by remote sellers over their platforms) to collect and remit sales taxes on behalf of such sellers. Many taxpayers were troubled by the speed with which states enacted legislation and regulations requiring the collection of sales taxes by remote sellers and marketplace facilitators, including concerns that certain states did not sufficient simplify their systems to avoid undue burdens being imposed on remote sellers, particularly states with local sales taxes. For example, the small business thresholds for requiring tax collection in some states are either nonexistent or unrealistic given the size of the state and complexity of its laws. These concerns are exacerbated by the newly created obligations imposed on marketplace facilitators – a classification that is defined differently from state to state - collecting taxes in place of such sellers.

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Taxpayers are increasingly concerned about the growing need for clarity regarding nexus standards, and the lack of uniformity and consistency regarding sourcing rules and the collection and administration of state and local sales taxes. This concern is heightened by steps recently taken by some states to expand nexus with respect to income taxes by adopting the economic nexus thresholds incorporated into state sales taxes as well as other nexus theories promoted by the states, such as “cookie nexus.”[13] The Multistate Tax Commission plans to release a white paper early in 2020 that will likely reinterpret and limit longstanding Federal taxpayer protection against income tax provided by P.L. 86-272,[14] in the context of our 21st Century digital economy. With the law unclear regarding the constitutional parameters of nexus standards under the Due Process and Dormant Commerce Clauses, and a lack of clarity regarding whether recently enacted state income and sales tax laws discriminate or impose an undue burden on interstate commerce, a spike in state tax litigation is increasingly likely. This uncertainty could cause businesses of all sizes to seek clarity in the courts as they attempt to navigate this wave of confusing new laws and the risk of aggressive state tax assessments in a post-*Wayfair* world.

Several bills have been reintroduced in the 116th Congress intended to address administrative concerns raised by remote sellers as well as to reestablish the physical presence standard. Bills addressing administrative concerns include: the Online Sales Simplicity and Small Business Relief Act (S. 2350, H.R. 1933), introduced by Sen. Jeanne Shaheen (D-NH) and Reps. James Sensenbrenner (R-WI) and Anna Eshoo (D-CA), and the Protecting Businesses from Burdensome Compliance Cost Act (H.R. 379), introduced by Rep. Bob Gibbs (R-OH). Legislation reestablishing the physical presence standard, the Stop Taxing Our Potential Act (S. 128), was reintroduced in the Senate by Sen. Jon Tester (D-MT) and Senators from two states without sales taxes.

Other Federal legislation affecting state taxes has been reintroduced in this Congress, and could possibly be included in a legislative package moving before the end of this Congress. The Mobile Workforce Income Tax Simplification Act (S. 604 and H.R. 4796), introduced by Sens. John Thune (R-SD), Sherrod Brown (D-OH), and Rep. Greg Steube (R-FL), benefits from strong bipartisan, bicameral support in prior Congresses. A bipartisan Senate bill was reintroduced early in 2019 with 32 original cosponsors, but the House version was not reintroduced until late in 2019 and lacked a Democratic cosponsor. Other bipartisan bills reintroduced in this Congress include the Digital Goods and Services Tax Fairness Act (S. 765, H.R. 1725), introduced by Sens. Thune and Wyden (D-OR) and by Reps. Steve Cohen (D-TN) and John Ratcliffe (R-TX), and the Business Activity Tax Simplification Act (H.R. 3063), introduced by Reps. Steve Chabot (R-OH) and Robert “Bobby” Scott (D-VA).

[13] Under this standard, state tax nexus is created by virtue of data files that websites store on users’ computers located in the state.
[14] P.L. 86-272 generally prevents a state from imposing a net income tax on an out-of-state business selling personal property to residents of the state if the businesses activities in the state are limited to the solicitation of orders which are approved by the business outside the state.

Regulatory Outlook

Regulations and other guidance on the TCJA

In 2019, the Treasury Department and the Internal Revenue Service issued a substantial amount of regulations and other guidance to implement the TCJA. Such guidance included (among others):

- Final regulations on the section 965 transition tax;
- Final regulations on section 956 inclusions;
- Final regulations under section 951A on global intangible low-taxed income (GILTI) (along with proposed regulations for the GILTI high-tax exclusion);
- Final regulations regarding foreign tax credits (along with proposed regulations on allocating and apportioning research expenses, stewardship expenses and foreign taxes, and rules related to foreign tax credit determinations);
- Final regulations on base erosion and anti-abuse tax (BEAT) (along with proposed regulations to allow a waiver of deductions for regular tax purposes);
- Final regulations under section 1400Z-2 on Opportunity Zones;
- Final and new proposed regulations under section 168(k) on the additional first-year depreciation deduction;
- Final regulations and other guidance under section 199A on the qualified business income deduction and new proposed regulations (relating to cooperatives and their patrons);
- Final regulations related to the state and local tax deduction limitation (including under section 170 for contributions in exchange for state or local tax credits);
- Temporary and proposed regulations under section 245A related to extraordinary dispositions and extraordinary reductions;
- Proposed regulations under section 162(m) on the deduction limitation for employee remuneration in excess of $1 million;
- Proposed regulations under section 250 on foreign derived intangibles income (FDII);
- Proposed regulations under section 382(h);
- Proposed regulations under sections 451(b) and (c);
- Proposed regulations under sections 863(b) and 865(e)(2) related to the source of income from sales of personal property (including inventory) and effectively connected income;
- Proposed regulations and a revenue procedure related to the repeal of section 958(b)(4) (downward attribution);
- Proposed regulations related to the section 1297 passive foreign investment company (PFIC) insurance exception; and
- Proposed regulations under section 4968 on the net investment income tax on certain private colleges and universities.

In 2020, the Treasury Department and the IRS will continue their focus on issuing regulations to implement the TCJA. Treasury Assistant Secretary (Tax Policy) Kautter has stated the

government's "ambitious goal" is to release guidance on every TCJA-related provision by fall of 2020.[15]

On January 16, 2020 Ranking Member Wyden and four other Finance Committee Democrats sent a letter to Treasury and OMB requesting information relating to the implementation of the TCJA international provisions. "…It now appears that Treasury and the OMB are using the new system's complexity as a means to give even more tax cuts to corporations through the secretive regulatory process where corporations and their armies of lobbyists exercise undue influence," the Senators said in the letter. Among the requested information are analyses of international regulations' impact on federal revenues, a list of meetings with lobbyists, copies of emails and other communication with lobbyists, and legal analysis drafted by the general counsel's office on the authority of Treasury to interpret the TCJA international provisions. At this time, it is unclear whether this investigation will slow down Treasury's efforts to complete TCJA guidance.

Based on the most recent Treasury/IRS Priority Guidance Plan (PGP) (dated October 8, 2019) and comments made by government officials, the attached chart provides a status summary of key TCJA guidance projects expected to be acted upon in 2020. As of the date of publication, only four of these projects have gone to OMB's Office of Information and Regulatory Affairs (OIRA) for review. While OIRA may waive review of some regulations, we expect OIRA to continue reviewing many of the projects on this chart as they have done with most of the key TCJA-related regulations issued to date, which, over the latter part of 2019, has added approximately a month to the process.

Other regulatory guidance

While TCJA implementation is the top guidance priority for Treasury and IRS, other projects may also see action in 2020. The PGP includes over 150 non-TCJA related guidance projects. Such projects include the following in the category of regulatory burden reduction pursuant to E.O. 13789:

- Section 385. An advance notice of proposed rulemaking under section 385 was published on November 4, 2019, announcing an intent to issue proposed section 1.385-3 distribution regulations that would be more targeted and streamlined. The same day, Treasury and the IRS removed the section 1.385-2 documentation regulations and said they may propose a simplified and streamlined version in the future.
- Section 707. Proposed regulations were published June 19, 2018 to withdraw temporary regulations published October 5, 2016 regarding the treatment of partnership liabilities for disguised sale purposes. The PGP includes finalizing the proposed regulations.
- Section 987. Notice 2019-65 was released December 6, 2019, announcing an intent to defer the applicability date of the final regulations under section 987 by an additional year, to tax years beginning after December 7, 2020. Thus, Treasury and IRS will need to address this issue by the end of 2020.
- Section 7602. The Taxpayer First Act was signed into law on July 1, 2019. The PGP includes proposed regulations under section 7602 to implement the Taxpayer First Act. The PGP also includes seven other Taxpayer First Act Guidance projects.

[15] For an overview of the status of outstanding regulations related to the TCJA, see the attached chart.

Other notable projects in the PGP include the following:

- Section 901(m). Temporary and proposed regulations under section 901(m) on covered asset acquisitions were published on December 7, 2016. The Temporary regulations expired in December 2019 (see section 7805(e)). Final regulations are included in the PGP.
- Section 861. The PGP includes regulations under section 861, including on the character and source of income arising in transactions involving intellectual property and the provision of digital goods and services. Proposed regulations on the characterization of digital content and certain cloud transactions were published on August 14, 2019.
- Section 1001. The PGP includes two projects under section 1001: (i) regulations on the modification of debt instruments, including issues relating to disregarded entities; and (ii) proposed and final regulations on the elimination of interbank offered rates (proposed regulations were published October 9, 2019)).
- Virtual currency. The PGP includes guidance concerning virtual currency. See below for a discussion.

Virtual Currency

Last year there was an uptick in Treasury guidance and IRS activity related to virtual currency. The first guidance on virtual currency came in 2014, when Treasury issued Notice 2014-21 providing that virtual currency is treated as property for U.S. federal tax purposes and that general tax principles apply to transactions using virtual currency. The notice explained, in the form of 16 frequently asked questions (FAQs), the application of general tax principles to the most common transactions involving virtual currency, including mining transactions and the receipt of virtual currency in exchange for services. Many more questions remained and additional questions were raised, but guidance was not immediately forthcoming.

The IRS has determined that the vast majority of virtual currency transactions were not being reported on tax returns. Beginning last year, the IRS began addressing potential non-compliance through a variety of efforts ranging from taxpayer education to audits to criminal investigations. For example, the IRS announced that it began mailing "educational letters" to more than 10,000 taxpayers that it believed may have reported transactions involving virtual currency incorrectly or not at all.

On October 9, 2019, the IRS issued a revenue ruling (Rev. Rul. 2019-24) regarding the tax treatment of virtual currency "hard forks" and "air drops" along with 43 FAQs addressing virtual currency transactions for taxpayers holding virtual currency as a capital asset, including guidance on buying goods and services with virtual currencies and calculating the basis and fair market value of virtual currencies.

The IRS is not planning on proposing a new set of rules applicable specifically to virtual currency transactions. Instead, it believes that virtual currencies are closely aligned with "property" under the tax code and rules applicable to property will continue to apply to virtual currency transactions. Although property treatment causes friction for virtual currency as a

medium-of-exchange, it offers more clarity and comfort to lawmakers and enforcement agencies like the IRS because the tax rules applicable to property are well defined in the tax code. Taxpayers and practitioners can rely on an extensive history of case law to make good faith assumptions on how to deal with virtual currency transactions.

Late last year, IRS Chief Counsel Michael Desmond stated that there is a "very serious compliance problem" with virtual currency taxation and that the biggest problem the IRS is facing is that taxpayers are not reporting anything at all. In the coming months, according to Desmond, the IRS will tackle the virtual currency compliance in two ways: guidance and enforcement.

Additionally, the IRS has shifted its focus to information reporting for brokers under section 6045 in the next round of guidance. The IRS is also considering international reporting requirements under the Foreign Account Tax Compliance Act and whether virtual currency accounts held by foreign exchanges need to be reported on the Financial Crimes Enforcement Network's Form 114, Report of Foreign Bank and Financial Accounts.

The IRS has circulated a draft of the new Form 1040, Schedule 1, Additional Income and Adjustments to Income, in an email to tax software companies that would ask taxpayers whether they had any transactions in virtual currency during the tax year. This is the main form that U.S. taxpayers use to report their income and will send a clear signal that taxpayers need to report their virtual currency transactions. The IRS is also trying to make the 1099-K reporting more stringent for U.S. based virtual currency exchanges. Although 1099-Ks do not report anything truly meaningful for taxpayers who want to calculate capital gains and losses, they have been proven to significantly increase the compliance rate in other areas of low compliance.

This past summer's announcement of Facebook's Libra (a "stablecoin," which is a virtual currency backed by a basket of low-volatility fiat currencies) garnered significant political attention on Capitol Hill. Several hearings were held in both the Senate Banking Committee and the House Financial Services Committee. However, neither the House Ways and Means Committee nor the Senate Finance Committee seem eager to move ahead of the IRS in light of its recent Revenue Ruling, FAQs and the demonstrated attention to increasing virtual currency compliance by senior Administration officials. We expect the tax-writing committees to continue to monitor these developments and address issues if the Administration lacks the statutory authority to address Treasury's compliance and enforcement concerns.

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International Tax Issues

OECD Work on a Global Tax Overhaul – "Choppy Waters" in 2020

In 2019 the OECD continued to dominate the global tax stage, seeking to achieve worldwide consensus on the tax challenges arising from the digital economy. These OECD efforts date back to Action One of the OECD Base Erosion and Profit Shifting (BEPS) project and have culminated in a cadre of international tax proposals, which have drawn corporate C-suite-level attention. Those tax proposals have arisen as a response to various unilateral actions by foreign governments implementing digital services taxes (DSTs), which have brought a wave of powerful political forces to the negotiating table seeking to avoid further proliferation of DSTs. Although DSTs have generally been designed to target a limited subset of technology companies, the OECD tax proposals, intended to stop that proliferation, could impact a much larger scope of multinational companies. As we enter the new decade, the global tax community is navigating through some "choppy waters,"[16] looking for "an exit ramp from a very messy situation."[17]

How did we arrive here and what should we expect in 2020? A recap of 2019 activity, then a forecast:

Background – Building the Two Pillars

Early in 2019, in order to resist the expansion of DSTs across the world and ensure a seat at the table to find a broader-based solution that did not single-out digital companies, the U.S. Treasury worked with the OECD to release an OECD public consultation document entitled *Addressing the Tax Challenges of the Digitalization of the Economy*. That document set forth the agreement of the then-129 OECD Inclusive Framework (IF) members to examine proposals involving two pillars: (1) "Pillar One" – revised profit allocation and nexus rules; and (2) "Pillar Two" – a global anti-base erosion proposal. Pillar One included three proposals under examination, one focused on user participation (U.K.), one on marketing intangibles (U.S. Treasury), and another on significant economic presence (India/Colombia). Pillar Two, primarily driven by Germany and France, had two main components: an income inclusion rule (i.e., a minimum tax) and a tax on base-eroding payments. The OECD held a two-day public consultation on that document in March.

That public consultation resulted in the OECD releasing at the end of May a "Programme of Work" (PoW) that added additional meat on the two pillar bones, providing detailed instructions to the IF and its technical working groups to develop the two pillars. Consistent with the February document, the PoW described Pillar One as the allocation of taxing rights, and undertaking a coherent and concurrent review of the profit allocation and nexus rules. Pillar Two focused on remaining BEPS issues to develop rules that would provide a country with a right to "tax back" where other countries had not exercised their primary taxing rights or the payment is otherwise subject to low levels of taxation. While exploring the two pillars, the PoW also described its plan to produce an economic analysis and impact assessment in connection with

[16] Pascal Saint-Amans, OECD Director, Centre for Tax Policy and Administration
[17] Chip Harter, Treasury Deputy Assistant Secretary, International Tax Affairs.

this project (e.g., potentially which countries are revenue winners and losers) and reiterated its goal for the IF members to agree on a global solution in 2020.

U.S. v. France – Carrot-and-Stick

While the OECD's efforts for a consensus-based two-pillar approach were endorsed in June by the G20, the rhetoric between U.S. and France in the summer began to heat up on the DST front. On July 10, the USTR initiated a Section 301 investigation into France's proposed DST, focusing on evidence that the DST discriminated against U.S. companies, that its retroactive nature called into question its fairness, and that it was unreasonable tax policy. France, however, remained undeterred, and that same week the French Senate passed a 3-percent DST on the turnover from online advertising, sale of data for advertising purposes, and fees derived from linking users to online sales platforms. The tax applied retroactively from January 1, 2019 and was estimated to affect about 30 companies (only one of which was from France). Two weeks later, President Macron signed the DST into law.

Responding to the French DST, Secretary Mnuchin stated the U.S. would "run a two-track process," noting USTR would continue its 301 investigation with a view to respond with tariffs (i.e., the stick) while Treasury would simultaneously continue its efforts to find consensus at the OECD that would lead to increased allocation of revenue to market jurisdictions (i.e., the carrot). In a tweet following French DST enactment, however, President Trump focused exclusively on the stick: "France just put a digital tax on our great American technology companies. If anybody taxes them, it should be their home Country, the USA. We will announce a substantial reciprocal action on Macron's foolishness shortly. I've always said American wine is better than French wine!"[18]

Summer's end brought more drama. Speaking alongside President Trump at the G-7 meeting in late August, President Macron made a surprise announcement that France and the U.S. had reached a "very good agreement" on the DST, implying that once an OECD agreement is reached, France would repeal its DST and refund to taxpayers the difference between the amount of DST paid and amount of tax owed under the OECD plan. While that announcement sparked some confusion, including whether the alleged deal included suspending the Section 301 investigation, an explanation Secretary Mnuchin gave two weeks later suggested something significantly more modest, stating that the countries agreed to "spend 90 days trying to work to see if the U.S. and France could reach an understanding, a conceptual understanding, on an international agreement."

Proposed Pillar One Unified Approach – As Easy as ABC?

Negotiations continued in earnest. And within that 90-day window, on October 9, the OECD released a public consultation document entitled *Secretariat Proposal for a "Unified Approach" under Pillar One*. Under the Unified Approach, the OECD proposal sought to bring together common elements of the three competing member country proposals laid out in the earlier documents, proposing new nexus and profit allocation rules for to-be-defined "consumer-facing businesses" (i.e., the scope). Specifically, for consumer-facing businesses, the proposal would

[18] Donald J. Trump (@realDonaldTrump), July 26, 2019, 12:32 PM.

create a new nexus, not dependent on physical presence, but largely based on sales, with the possibility of country-specific thresholds.

The proposed new profit allocation rule, explicitly acknowledged to reach beyond the arm's length principle, would apply to all in-scope taxpayers—whether or not they had in-country marketing or distribution presence or sell via unrelated distributors. The proposed Pillar One had three tiers: Amounts A, B, and C.

- Amount A represented a *new taxing right* for markets, and would be a share of an in-scope company's deemed residual profits, determined under a to-be-defined formulaic approach;

- Amount B represented a fixed return to market countries for baseline marketing and distribution functions taking place in that market; and

- Amount C was described as binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

The breadth and scope of the Unified Approach took many non-digital companies by surprise. Companies had to determine whether they fell in the "consumer-facing" net, and, if so, the potential implications of this vast global tax overhaul. Between October 9th and the public consultation held in Paris just before Thanksgiving, a diverse set of U.S. companies and trade associations provided their feedback to both the OECD publicly and U.S. Treasury privately.

Treasury's Course Correction – the Safe Harbor

As a result of feedback from the U.S. business community, in a December 3 letter to OECD Secretary-General Ángel Gurría, Secretary Mnuchin provided a pivotal update on the U.S. position, surprising many in the international tax community and changing the trajectory of the Pillar One negotiations. In that letter, Secretary Mnuchin cited to two different "pillars" of taxation—arm's length transfer pricing and taxable nexus; in doing so, he expressed "serious concerns regarding potential mandatory departures" from those two "longstanding pillars of the international tax system upon which U.S. taxpayers rely." Instead of a mandatory approach, Secretary Mnuchin proposed turning Pillar One into a "safe-harbor regime" to which companies (and presumably countries) could opt in. Such a voluntary approach, Secretary Mnuchin believed, would address "taxpayer concerns" but still "substantially achieve" Pillar One's goals.

That course correction drew a quick and skeptical response from both the OECD and France. In a letter to Secretary Mnuchin the following day, OECD Secretary-General Gurría expressed surprise about this new position, stating that "through the extensive consultation process … we had so far not come across the notion that Pillar One could be a safe harbor regime." Moreover, Gurría's letter suggested Treasury's position was an about-face, asserting that Secretary Mnuchin and his delegates were the initial driver in broadening Pillar One's scope. Specifically, he cited to Secretary Mnuchin's "personal involvement … that steered the international community away from seeking a narrow digital solution and introduce innovative proposals" and his "personal

interventions at G20 meetings that moved the discussions to a broader scope using a more formulaic approach and a new nexus concept that moved us beyond the tax rules as they currently stand." In conclusion, noting that the process was at a "critical juncture", Gurría invited Secretary Mnuchin to meet with him and French Minister Bruno Le Maire at his "earliest convenience, ideally before Christmas." A day later, Minister Le Maire's response was even more scathing: "Frankly, I don't put a lot of stock in the American proposal for an optional solution where companies are free to decide. I haven't seen a lot of companies that freely accept to be taxed. We can always count on people's philanthropy, but it doesn't go very far for the public finances."

Modified U.S. Pillar One Proposal

Although Secretary Mnuchin was unavailable to accept the pre-Christmas invitation and sought to meet with Minister Le Maire early in the new year (see DST section below for more detail on that meeting), Treasury DAS Chip Harter, at a conference in late December, expanded on Secretary Mnuchin's letter and Treasury's position in several respects.

Because the U.S. business community's reaction to the Unified Approach was so "deeply divided," Treasury believed there was "no room or hope" for Congress to pass legislation and tax treaties changing nexus and transfer pricing rules on a mandatory basis. Thus, it would not serve any useful purpose for the Treasury to sign on to a multilateral agreement that Congress would be unable to implement. That said, if Pillar One were made a safe harbor, Treasury believes it would be "a very attractive proposition" for companies because of the tax certainty it would provide, with a more formulaic approach to transfer pricing and access to mandatory binding dispute resolution measures.

Moreover, according to Harter, the Unified Approach's plan to reallocate taxing rights only for "consumer-facing businesses" was particularly controversial, both with respect to defining what businesses are "consumer-facing" as well as the rationale for why wholly digital business-to-business sales would not be in scope. Harter also reiterated Secretary Mnuchin's concerns about a new nexus threshold that would cover sales through an unrelated distributor.

To address both of those issues, Harter said that the U.S. has advanced to the OECD an opt-in Pillar One proposal that expands the scope while at the same time narrows the nexus of the proposed Unified Approach. Specifically, the consumer-facing scope would be expanded to include business-to-business "scale without mass digital business models," but nexus would be narrowed so that a country could exercise the new taxing right under Amount A only if a company satisfies one of four criteria: (1) is a part of a global enterprise with a taxable presence under traditional PE rules; (2) sells digital goods and services into a market jurisdiction from offshore; (3) sells into a market jurisdiction without direct participation in that market but has spent a substantial amount offshore on targeted advertising or brand development; or (4) licenses or franchises consumer brands into a country from offshore. In other words, if a company's products are used or consumed in a country where none of those four criteria occurred, then that country would not receive a share of Amount A. Treasury believes this approach would capture 90 to 95 percent of sales into a country.

Pillar One – Next Steps

During the same December conference at which Harter fleshed out the new U.S. proposal, Pascal Saint-Amans, who heads the OECD project, announced that the question of Pillar One's optionality would not be decided by the now-137 member IF unless and until there is an agreement on Pillar One's architecture. Almost a month later on January 16 at a Berlin conference, however, Saint-Amans expressed extreme skepticism on optionality, stating that the proposal won't find consensus and is "acting as a barrier to discussions." He further quipped, "if we could make tax optional, we should also make death optional and I would vote for that." At the same January conference, Martin Kreienbaum, head of international tax at the German Ministry of Finance, poured more cold water on the idea, stating his belief that the U.S. proposal is a "no-go politically" and would create technical problems for the broader plan. He did, however, include a caveat that "we are willing to compromise on Pillar One, if there is a Pillar Two as well, the two are politically linked."

So what's next? This month, the OECD will continue working to form consensus within the IF on an outline of Pillar One's architecture, which is expected to include more details on scope, nexus, and dispute resolution. This outline is expected to note U.S. Treasury's position on optionality and the reaction of other counties to that position. This outline, which may be agreed to "without prejudice," will be presented to G-20 finance ministers for their February meeting in Saudi Arabia, at which time it is expected to be made public. Following the outline's release, the OECD will focus on attempting to achieve consensus among countries on the main features of Pillar One (including optionality) by July 2020. Waiting too long to decide on optionality, however, poses a risk that more countries in the interim will act unilaterally on their own DSTs (as discussed more below).

In addition to details on scope, nexus, and dispute resolution, Pillar One's architecture could potentially address other outstanding details, such as the determination of Amount A (formula, line of business, treatment of losses, combined cap on Amounts A and B), allocation key for Amount A, determining the surrender jurisdiction and elimination of double taxation, and the payment of tax. Additionally, any opt-in proposal would require additional detail, such as time and manner of election, whether an election could be made on a line-of-business basis, and whether such election is to be made annually or is binding for a certain term of years.

Contemporaneous with Pillar One technical and political discussions, the OECD continues to work on modeling and analysis on both pillars, and may publish findings regarding both economic analysis and impact assessments during the first half of 2020.

Pillar Two – Update and Next Steps

While Secretary Mnuchin's letter altered the course of Pillar One, that same letter stated that the U.S. "fully supports a GILTI-like Pillar Two solution." A month earlier, the OECD had released a Pillar Two public consultation document entitled *Global Anti-Base Erosion Proposal ("GloBE")*. Building off of the PoW, the GloBE proposal sought to comprehensively address remaining BEPS challenges by ensuring that a multinational's profits are subject to a minimum rate of tax, through four main component parts:

1. *an income inclusion rule* that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate;

2. *an undertaxed payments rule* that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at or above a minimum rate;

3. *a switch-over rule* to be introduced into tax treaties that would permit a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a PE or derived from immovable property (which is not part of a PE) are subject to an effective rate below the minimum rate; and

4. *a subject to tax rule* that would complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and adjusting eligibility for treaty benefits of certain items of income where the payment is not subject to tax at a minimum rate.

The GloBE document specifically requested comments on three technical design aspects of the proposal: (1) using financial accounts as a starting point for determining the tax base; (2) allowing blending of income and taxes either globally or jurisdictionally; and (3) potential carve-outs and thresholds. According to the document, the actual rate of tax would be discussed only after those design elements were fully developed. Those design aspects, in the context of the income inclusion rule, were indeed the focus of the Pillar Two public consultation held in France in early December. Many of the U.S. stakeholder comments stated, and a "red line" effectively drawn by U.S. Treasury has been, that U.S. GILTI must be grandfathered as a qualified income inclusion rule, so that U.S. companies would not be subject to the backstop rules (i.e., undertaxed payments or subject-to-tax rules) that would kick in for companies headquartered in a country that does not have a qualified income inclusion rule.

That U.S. position could result in a potentially contentious 2020 issue – whether other countries will agree to a GILTI grandfather, at the same time that companies headquartered in those countries would still remain subject to the U.S. BEAT regime, even if those countries themselves had adopted a qualified income inclusion rule. Thus, in negotiations to obtain a GILTI grandfather, other countries are likely to ask U.S. Treasury to consider agreeing to some form of a treaty modification that could effectively override the BEAT. That said, agreeing to such an override could have its own challenges securing any subsequent U.S. Senate approval.

The OECD plans to provide an update on Pillar Two negotiations around the same time it releases its Pillar One outline in February 2020. Additionally, OECD officials have floated the idea of another public consultation, possibly in March 2020, focusing on some of the remaining issues in Pillar Two.

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More DSTs on the Horizon – Trade War Looming?

On December 2, the same week Secretary Mnuchin sent his letter to the OECD, USTR utilized its stick – it issued a notice of determination in its Section 301 investigation, concluding that the French DST discriminated against U.S. companies, is inconsistent with prevailing principles of international tax policy, and is unusually burdensome for affected U.S. companies. As a result, USTR proposed additional duties of up to 100 percent on certain French products, including champagne, cheeses, and beauty products, with about $2.4 billion in trade value. In the accompanying report, Ambassador Lighthizer warned other countries, specifically stating that USTR is exploring whether to open Section 301 investigations into the proposed DSTs of Austria, Italy and Turkey. A public hearing was held on January 7th where stakeholders commented on proposed actions (including over two dozen representatives from the wine industry). Tariffs may be imposed in the very near future.

Those warnings from USTR notwithstanding, more DSTs are expected. Specifically, Treasury expects at least six additional DSTs to go into effect in 2020.[19] Consistent with Ambassador Lighthizer's warning, Harter expects that the U.S. will retaliate through trade actions and believes it is likely that the E.U. will retaliate against any U.S. retaliation.

In an effort to avoid that potential tit-for-tat, on January 6th, Secretary Mnuchin had a "long discussion" with Minister Le Maire on digital tax-related issues, where, according to Minister Le Maire, the two "agreed to redouble … efforts in the coming days to try to find a compromise on digital taxation in the framework." To that end, Minister Le Maire told reporters that he and Secretary Mnuchin "gave ourselves 15 days, until our next meeting in Davos in end-January, … to try all options to reach an agreement at the OECD." If no such agreement is reached by that time, it is likely that the U.S. will impose tariffs pursuant to the Section 301 investigation.

If those tariffs are imposed, the transatlantic trade dispute likely will escalate. Indeed, in early January, Minister Le Maire called the potential tariffs "highly disproportionate" and would "mean the end of negotiations" at the OECD, further stating that, "if the Americans decide to impose trade sanctions against digital taxation, we will fight back within the framework of the WTO." Similarly, new E.U. trade commissioner David Hogan, in response to the proposed tariffs, said the EU will back France's "legitimate" digital tax, stating the EU "will act – and react – as one against any unilateral measures outside the multilateral trading system." Hogan met with Ambassador Lighthizer, Secretary Mnuchin, Commerce Secretary Wilbur Ross, and Congressional tax-writing committee members during his visit to Washington D.C. on January 14-16, 2020.

Increasing escalation is why, according to Harter, "the world needs an exit ramp from a very messy situation" and he "hope[s] that concentrates the minds of the countries around the [OECD] table and leads to success." In other words, as Saint-Amans bluntly stated, "there is no plan B," just "plan C, and C is for chaos if we don't reach agreement."

[19] For example, Italy's 3 percent DST took effect on January 1, 2020 and Turkey's 7.5 percent DST will go into effect on April 1, 2020.

Congressional role?

While Treasury and USTR have taken co-leading roles on the OECD and DST center stage, Congressional tax-writing committees have not been idle bystanders. Both Ways and Means and Finance Committee staff have had various meetings and briefings with Treasury and USTR staff, and each of the four tax-writing committee heads in 2019 released at least one public statement condemning unilateral DSTs and supporting the OECD process. More recently, Chairman Grassley and Ranking Member Wyden publicly supported USTR's findings on the French DST, stating they "welcome[d] this step from USTR on behalf of U.S. companies being unfairly targeted and harmed by the French tax" and "encourage[d] other member states considering similar action to work within the OECD framework toward a comprehensive solution."

During EU Commissioner Hogan's visit with Chairman Neal on January 15, Chairman Neal raised as a "priority matter" his "support of a multilateral process on our digital services tax disagreement" and "in particular, regarding digital taxes…reiterated how critical it is for American workers, businesses, and wine producers that the issue not persist and spark the imposition of severe tariffs." Similarly, Ways and Means Republicans also expressed to Hogan their insistence "that France end its discriminatory digital services tax on U.S. companies."

While neither tax-writing committee held a hearing in 2019 focusing on international tax issues related to the OECD and DSTs, it is expected that the Ways and Means Committee will do so during the first half of 2020.

Because any Pillar One (and potentially Pillar Two) agreement contemplates treaty changes that would need to be ratified by the U.S. Senate, the Senate Foreign Relations Committee will also have a role to play. While Treasury has not significantly engaged with Foreign Relations on the OECD front, those parties were in frequent contact with each other this past summer, which culminated in the Senate approving protocols to U.S. tax treaties with Japan, Luxembourg, Spain, and Switzerland. Those approvals were notable, as it had been nearly a decade since the Senate had ratified any treaties or protocols, in large part related to Sen. Rand Paul's (R-KY) privacy-related objections. While those four protocols sailed through the Senate once receiving floor time, three pending tax treaties—with Chile, Hungary, and Poland—have stalled over concerns regarding whether the BEAT violates articles 23 (double taxation relief) and 24 (nondiscrimination) of the U.S. model income tax treaty. Specifically, negotiations have been hung up over whether a treaty reservation would be necessary to clarify that treaty approval would not affect application of the BEAT. Those treaty negotiations taking the BEAT into account will continue into 2020 and could get wrapped up into OECD efforts if Pillar Two negotiations contemplate treaty modifications to BEAT-related issues.

Whether or not those treaties proceed, given the vast changes being contemplated on the global tax landscape, Congress could very well have a more active monitoring and oversight role in 2020 on international tax-related issues.

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Presidential Candidates' Tax Proposals

As the year progresses, there will be an increased focus on the Democratic presidential candidates' tax proposals. These proposals will set the stage for tax legislation that is considered in 2021, should a Democrat win the presidential election.[20]

Some Democratic candidates are proposing bold tax proposals, such as new wealth taxes and financial transaction taxes, while other candidates are proposing tax changes within the existing system, such as reinstating the top individual and corporate rates and lowering the estate tax exemption threshold. Most of the candidates propose undoing much or all of the tax changes in the TCJA. This is not surprising given that the bill was passed on partisan lines.

The Democratic candidates' positions on taxes differ greatly from those of President Trump, who counts the TCJA as one of his signature legislative accomplishments and often touts the successes of the tax cuts. The President is expected to deliver his annual State of the Union address on February 4 and the Administration's budget will shortly follow on February 10. It is not expected that new tax proposals will be a major part of either the address or the budget.

Although President Trump has not yet released a specific plan, National Economic Council Director Larry Kudlow said January 15 that the White House intends to unveil a plan for additional tax cuts later this year, potentially during the summer. He said during an interview on CNBC, "I am still running a process of Tax Cuts 2.0. We're many months away — it'll come out sometime later during the campaign." He declined to discuss specifics of the plan, saying only that would be designed to help middle-class economic growth. President Trump in 2019 also continued to express his desire for a large-scale infrastructure deal.

The differences between President's Trumps views on taxes and those of the Democratic candidates will remain a point of contention throughout 2020.

[20] For a detailed overview of the Democratic Presidential candidate frontrunner tax plans, see the attached chart.

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