

**Baker
McKenzie.**

Corporate Tax and Cross-Border Hot Topics

Southern Federal Tax Institute | October 28, 2025

TAX FROM EVERY ANGLE



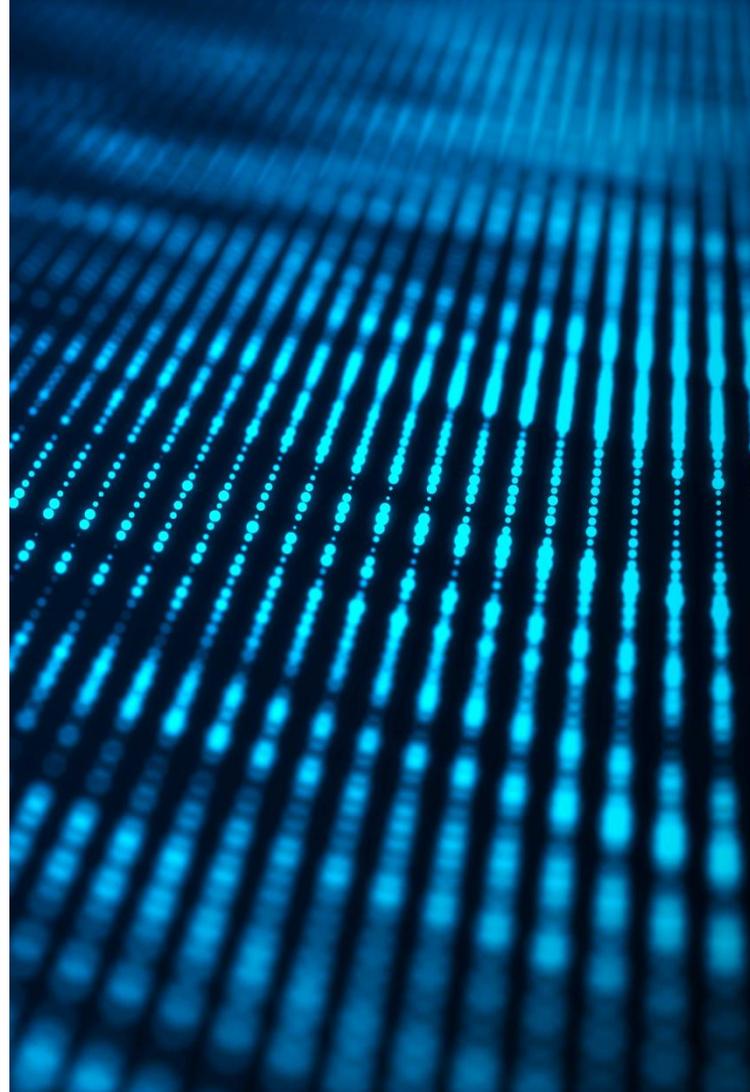
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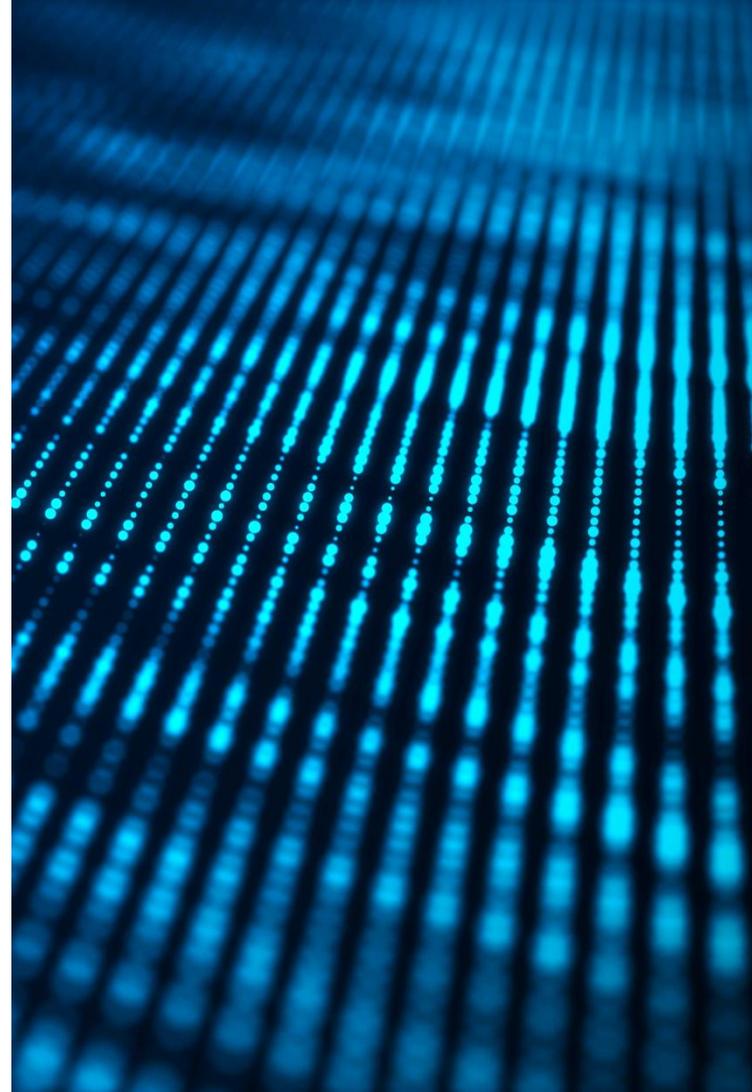
Agenda

01 Regulatory Update

02 Key Corporate and International Tax
Provisions in Need of Guidance

03 Pillar Two Update

04 Inversions Revisited



01 Regulatory Update





Timing, Process, and Taxpayer Feedback

- General Timeframe on Guidance Issuance
- Treasury and IRS Guidance Priorities
- Taxpayer Feedback

Treasury Regulatory Update

- Memorandum on the OECD Global Tax Deal (January 20, 2025)
- The “10-to-1” Deregulation Executive Order 14192 (January 31, 2025)
- Memorandum on Reciprocal Trade and Tariffs (February 13, 2025)
- Notice 2025-23 (Intention to Withdraw Partnership Basis-Shifting Regulation) (April 17, 2025)
- Notice 2025-27 (Determining Whether Corporation is Subject to CAMT) (June 2, 2025)
- Notice 2025-28 (CAMT’s Effect on Partnerships and Corporate Partners) (July 29, 2025)
- Notice 2025-44 (Withdrawal/Modification of DCL and PDL Regulations) (August 20, 2025)
- Notice 2025-45 (Proposed Changes to FIRPTA and F Reorganization Rules) (August 19, 2025)
- Notice 2025-46 (Proposed CAMT Changes to Corporate Provisions) (September 30, 2025)
- Notice 2025-28 (Proposed CAMT Changes to AFSI) (October 1, 2025)

Treasury Regulatory Update

Which corporate and international tax guidance might we expect in 2025?

- CAMT
- Section 355/Divisive Reorganizations
- Section 892
- BEAT
- Anything Else?
 - PTEP?
 - Cloud Sourcing?
 - Section 987?
 - Dual Consolidated Loss?
 - FDII and GILTI expense allocation?
 - Section 174?

02 Key Corporate and International Tax Provisions in Need of Guidance

Overview

- 01** Immediate domestic R&E expensing

- 02** GILTI revisions

- 03** FDII revisions

- 04** Section 898 – taxable year for CFCs

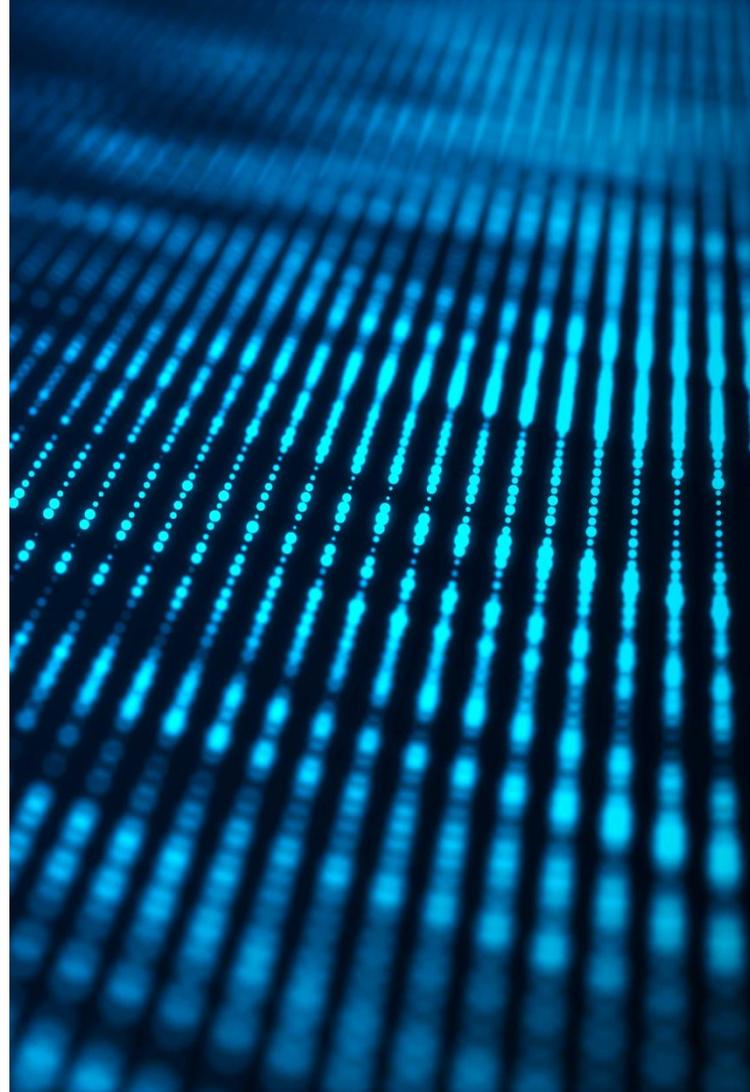
- 05** Section 954(c)(6) made permanent

- 06** FTC impacts including expense allocations and source of income

- 07** Downward attribution rule for stock ownership

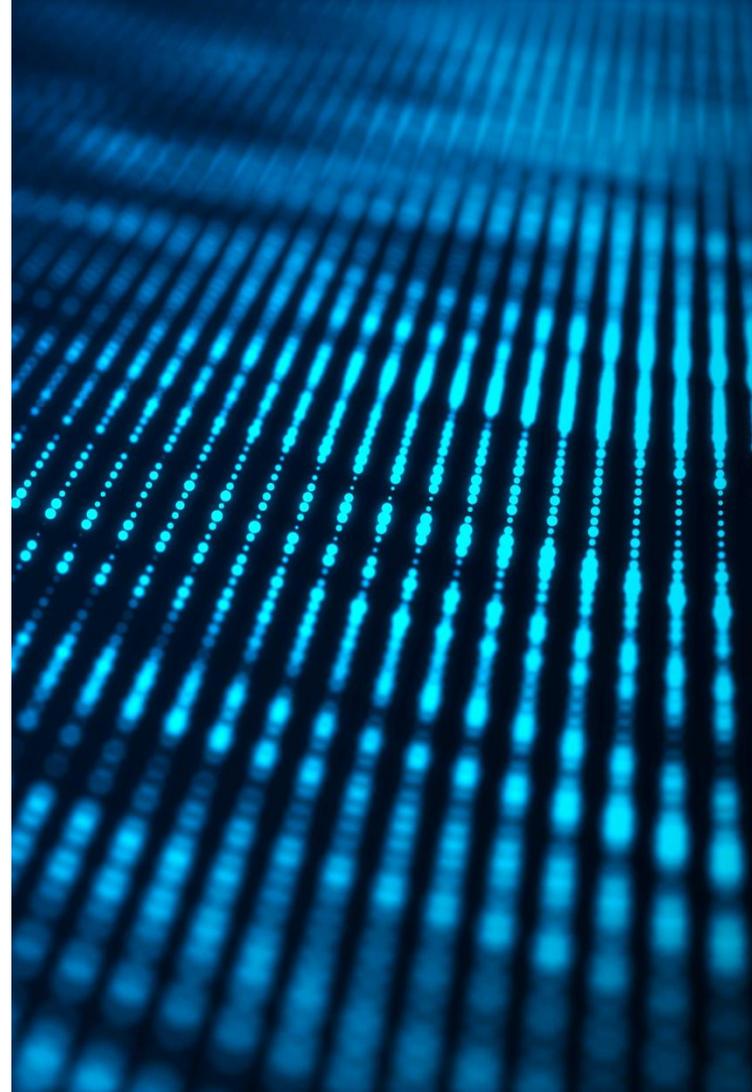
- 08** Pro rata share rule for deemed income inclusions

- 09** Changes to small business stock under section 1202





Immediate Domestic R&E Expensing: Section 174A



Return of Immediate Domestic R&E Expensing

Introducing Section 174A

Overview: New Section 174A permanently revives immediate expensing for **domestic** R&E expenditures (with elective 5-year capitalization), maintains 15-year capitalization and amortization for foreign R&E expenses.

Related/Corresponding Changes:

- Acceleration Election for outstanding amortization amounts – allows for accelerated amortization in first applicable tax year (over 1 or 2 years).
- Section 280C – Provides domestic R&E expenditures, whether deducted or capitalized, must be reduced by the amount of any R&E tax credit under section 41(a).
- Section 41(d)(1)(A) – changed the definition of qualified research to expenditures that “are treated as domestic research or experimental expenditures under section 174A”

Application Date: Changes apply to amounts paid or incurred in tax years beginning after Dec. 31, 2024.

Elective Five-Year Amortization of Domestic R&E

Section 174A(c)

Election to amortize domestic R&E for expenses:

- under regulations or other guidance from the Secretary
- for expenses otherwise eligible for section 174A
- that are not chargeable to depreciable property
- for a period not less than 60 months
- beginning in the month in which the taxpayer first “realizes benefits” from the expenditures

Rev. Proc. 2025-28

Provides that “a trade or business of a taxpayer may elect to capitalize and amortize all such expenditures [that is, domestic R&E] paid or incurred in the taxable year”

In addition:

- election is not permitted if taxpayer had changed its method of accounting with respect to domestic R&E under section 7.02(3) of Rev. Proc. 2025-23
- requires a statement attached to the return for the first year in which the election applies
- requires that the method and period will be used in all future years unless the applicant obtains the consent of the Commissioner to change

Return of Immediate Domestic R&E Expensing

“Doubling-Up” on R&E Amortization and Section 174A Immediate Expensing

2025 Domestic R&E Tax Deductions								
	2022	2023	2024	2025	2026	2027	2028	2029
Actual R&E Expenditures	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100
Tax amortization for 2022 Expenditures	\$10	\$20	\$20	\$20	\$20	\$10		
Tax amortization for 2023 Expenditures		\$10	\$20	\$20	\$20	\$20	\$10	
Tax amortization for 2024 Expenditures			\$10	\$20	\$20	\$20	\$20	\$10
2025 Expensing 174A				\$100				
2025 174/174A Domestic Tax Deduction				\$160				

The taxpayer’s taxable income is reduced by \$160 in 2025 , even though the taxpayer only had \$100 of R&E expenditures in that year

Return of Immediate Domestic R&E Expensing

Collateral Effects of “Doubling-Up” on R&E and Low Taxable Income

CAMT

- Taxpayers have a massive book-tax difference for the R&E amortization that was incurred between 2022 to 2024 and is being deducted in 2025 and thereafter
 - This R&E was already deducted for book purposes in 2022 to 2024
 - However, the amortization is just now being deducted in 2025 for tax purposes
- Many taxpayers will owe CAMT due to the “doubling-up” of R&E deductions for tax purposes (but not for book purposes)
- **Predicament:** Taxpayers with large R&D credits often cannot benefit from a CAMT credit because the section 53(c) limitation will prevent the taxpayer from ever using the credit (i.e., the taxpayer will have to book a valuation allowance for the CAMT credit)

Possible Solutions

1. Section 59(e) capitalization elections?
2. Are section 174A capitalization elections worthwhile?
3. Section 56A(c)(15)?

Return of Immediate Domestic R&E Expensing

Collateral Effects of “Doubling-Up” on R&E and Low Taxable Income

FDII and GILTI

- **Issue** – the doubling up of R&E reduces a taxpayer’s taxable income so that the sec. 250(a)(2) limitation is more likely to apply
- **Effect** – many taxpayers will have their GILTI and FDII deductions reduced under sec. 250(a)(2)

Overall Domestic Losses (ODL)

- **Issue** – the doubling up of R&E creates an overall domestic loss under sec. 904, which is then allocated and reduces a taxpayer’s GILTI sec. 904 FTC limitation
- **Effect** – Some taxpayers are unable to credit GILTI foreign taxes, which are then lost because GILTI FTCs cannot be carried forward

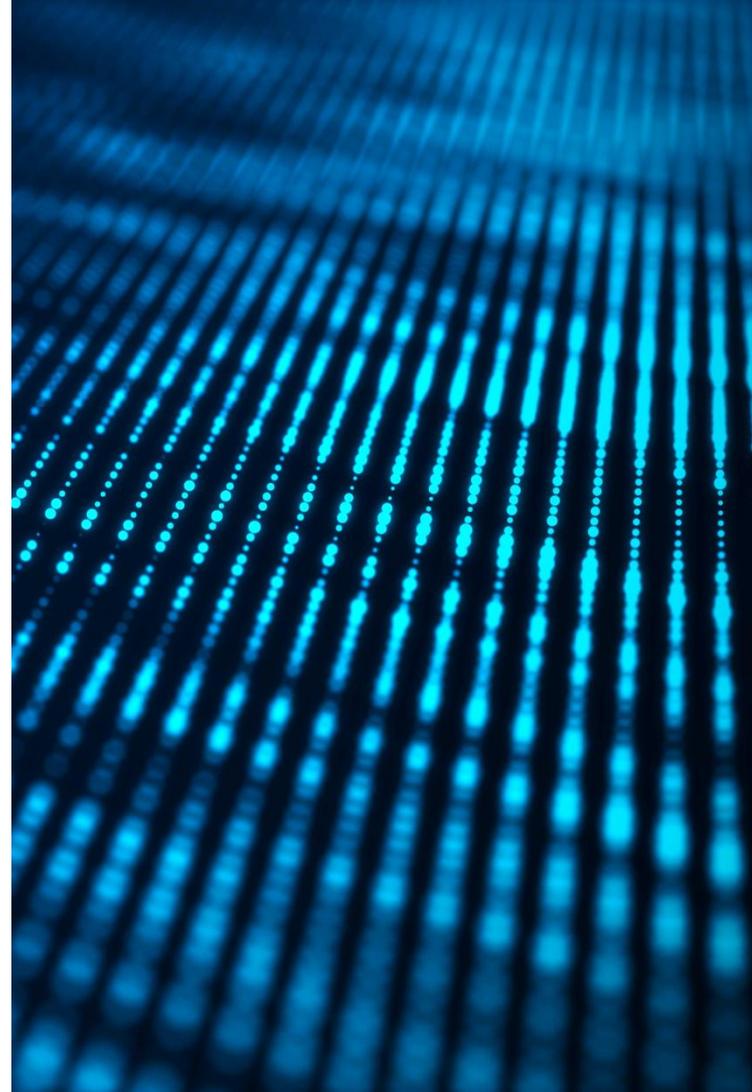
BEAT

- Some taxpayers owe more BEAT tax
- However, most taxpayers are less likely to owe BEAT because the amortization deductions increase the denominator of the 3% limitation fraction

Section 38(c) General Business Credit Limitation: taxpayers owe less tax and may have GBC credits that expire



GILTI NCTI Revisions



Net CFC Tested Income (NCTI): Overview

■ What changed?

- GILTI renamed NCTI as no longer related to intangible income and no longer a QBAI exclusion
- Section 250 deduction to 40% → 12.6% rate
- “Net deemed tangible income return” eliminated
- Section 960(d) haircut reduced to 10%
- Targeted 14% effective rate (\$14 of foreign tax 90% creditable = \$12.6)

■ But note that **jurisdictional blending** is still permitted

■ Why do the changes matter?

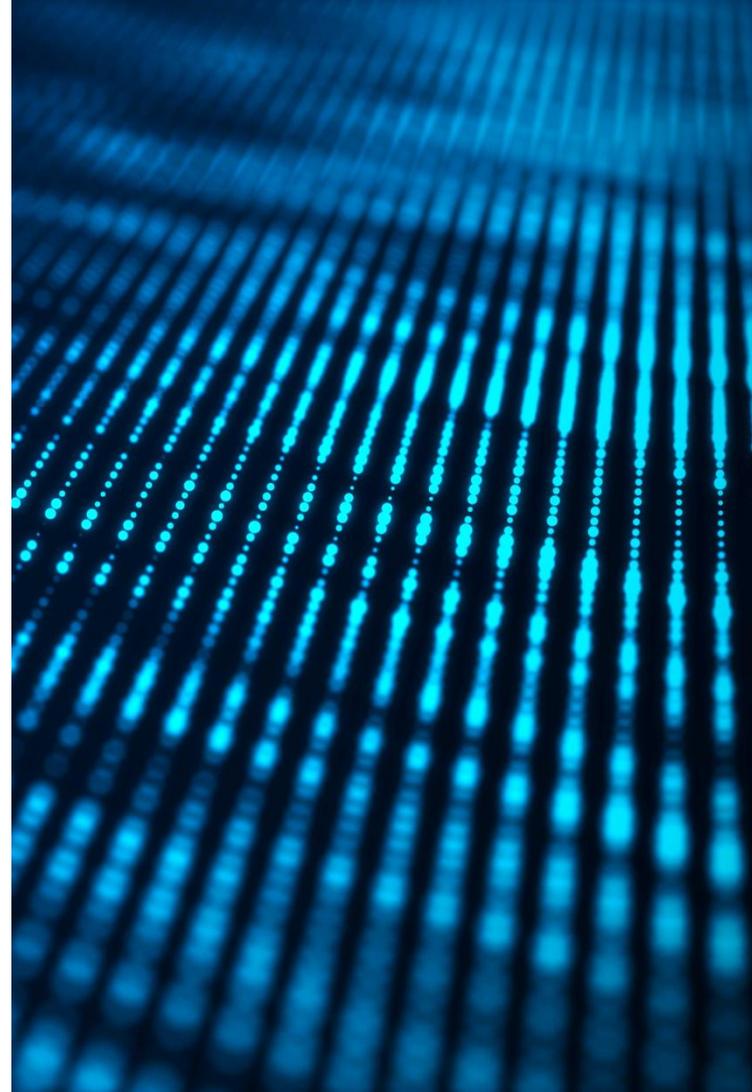
- Eliminates incentive to make capital investments offshore
- Moves the US that much closer to a worldwide full inclusion regime
- **Brings the US more in line with Pillar Two?**

Net CFC Tested Income (NCTI): PTEP Taxes

- Revised section 960(d)(4) provides that, “No credit shall be allowed under section 901 for 10 percent of any foreign income taxes paid or accrued (or deemed paid ...) with respect to any amount excluded from gross income under section 959(a) by reason of an inclusion in gross income under section 951A(a).”
- The effective date provision indicates that, “The amendment ... shall apply to foreign income taxes paid or accrued (or deemed paid or accrued under section 960(b)(1) ...) with respect to any amount excluded from gross income under section 959(a) ... by reason of an inclusion in gross income under section 951A(a) ... after June 28, 2025.”
- The plain language of the provision indicates that the relevant inclusion must occur after June 28, 2025.
 - However, some have expressed a view that the relevant exclusion (i.e., the distribution or the end-of-the-year; see AM 2023-002) must occur after June 28, 2025.
 - N.B. The effective date of the modification to section 78 is effective for taxable years after December 31, 2025.



FDH FDDEI Revisions



Amendments to FDII

- Effective for taxable years beginning after December 31, 2025
- Renames FDII to FDDEI as part of streamlining the calculation by removing:
 - QBAI / “net deemed tangible income return” and
 - Enhances FDDEI benefit for businesses with high QBAI (less impactful for low QBAI businesses)
 - the multiplication of DII by the Foreign Derived Ratio
- The new deduction rate for FDDEI is permanently set at 33.34%, which makes the eligible income subject to an approximately 14% (up from 13.125%) effective rate of tax.

DEI Deductions

■ Before OBBBA

- DEI was reduced by deductions properly allocable to the gross income
- Under the revised rule, expenses are also added to deductions, presumably to capture cost of goods sold, while the properly allocable standard is maintained

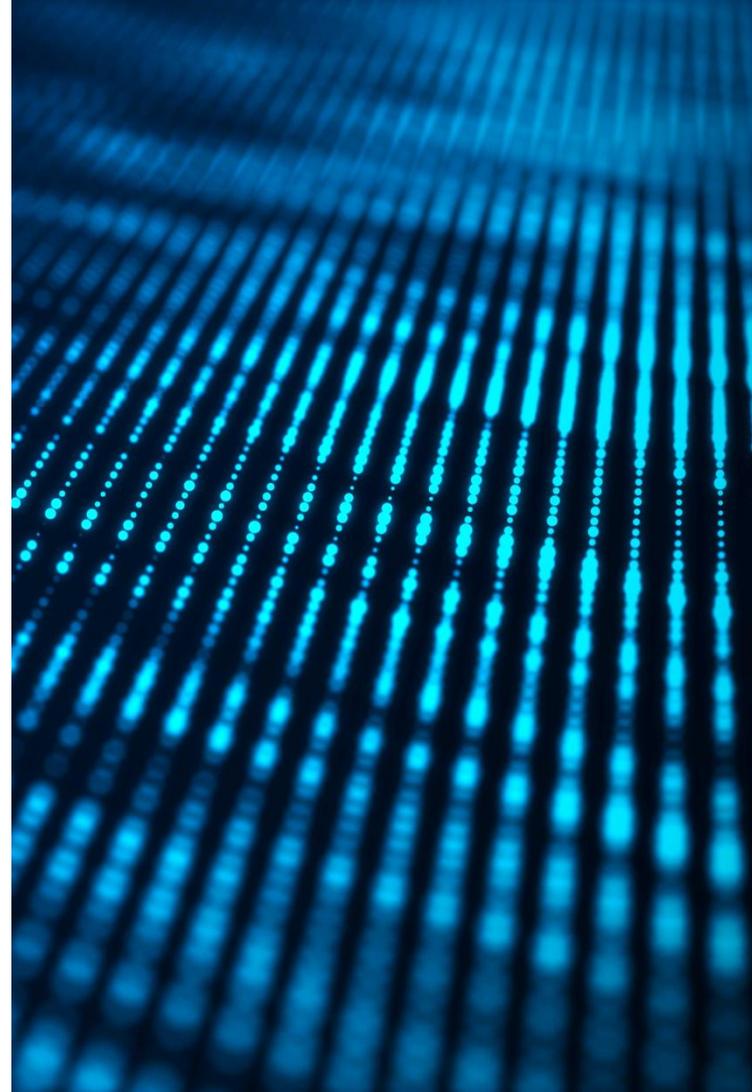
■ After OBBBA

- In 2026, interest expense and research and experimental (R&E) expenditures no longer reduce FDDEI
- Impactful as more DEI is able to qualify for the lower FDDEI rate
- However, downstream impact includes potential CAMT issues
- Some companies considering what qualifies as R&E expenditures



Section 898

Taxable Year for CFCs



Repeal of One-Month Deferral for SFCs

Before OBBBA:

- Section 898(c)(2) permitted a “specified foreign corporation” (“SFC”) to elect a taxable year beginning one month earlier than the majority US shareholder year
 - A SFC is generally a CFC that is majority-owned by a single US shareholder

After OBBBA

- OBBBA repeals the one-month deferral provision such that a SFC with, say, a calendar year majority US shareholder will now need to use 12/31 as its tax year-end
 - Effective date: SFC’s first tax year beginning on or after November 30, 2025
 - Transition rule: SFCs with one-month deferral elections in place would have, for their first year beginning after November 30, 2025, a one-month short year
 - For calendar year taxpayers this means that any in-scope SFC would have a short year from December 1, 2025, to December 31, 2025, and then would have its first calendar tax year in 2026

Repeal of One-Month Deferral for SFCs

- Any required change in tax year will be treated as having been initiated by the corporation and made with the Secretary's consent
- IRS authorized to issue guidance for allocating foreign taxes accrued between the short tax year required under the transition rule and the following tax year
 - Treasury is granted regulatory authority to determine how foreign taxes will be allocated
 - The OBBBA provides that “[i]f any specified foreign corporation is required by [these] amendments ... to change its taxable year ... the Secretary **shall issue** regulations or other guidance for allocating foreign taxes that are paid or accrued in [the one-month year] and the succeeding taxable year among such taxable years in the manner the Secretary determines appropriate to carry out the purposes of this Section.” (Emphasis added).
- Shuts down the kind of planning that some taxpayers engaged in following enactment of the TCJA (e.g., relating to section 965 and the mismatched effective dates for section 245A and GILTI)

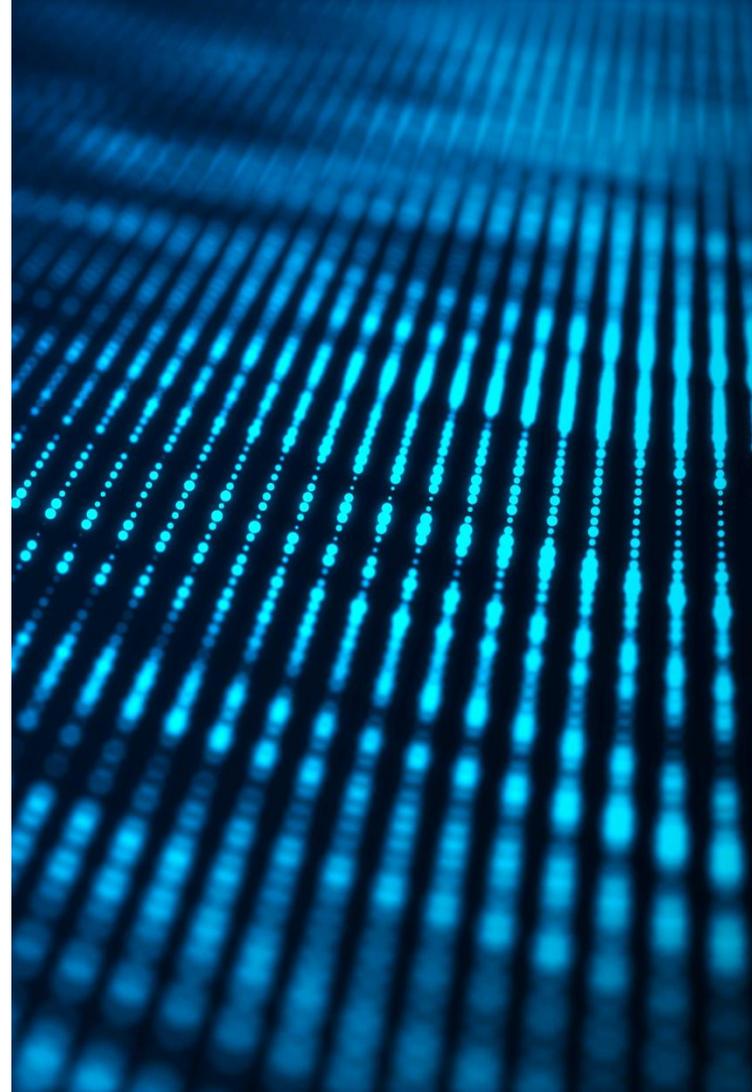
One-Month Deferral Rule Repeal Issues

- Is the regulatory grant “self-executing”? If so, the provision does not provide a clear rule for allocating taxes between the two relevant years.
 - Query what methods of allocation might be reasonable for taxpayers? Possible methods might include:
 - Proration based on number of days, or
 - Allocation based on foreign taxable income similar to the allocation method provided under Treas. Reg. section 1.901-2(f)(5) that follows the principles of Treas. Reg. section 1.1502-76(b).
- Certain other provisions allocate items to a taxable year, regardless of that year’s length.
 - For example, the section 987 regulations amortize certain losses over 10 taxable years.
 - Note that the allocation of these items to short years can create anomalies, such as tested losses.
 - Query to what extent Treasury can address such anomalies under its regulatory authority?



Section 954(c)(6)

Made Permanent



Permanent Extension of Section 954(c)(6)

Before OBBBA:

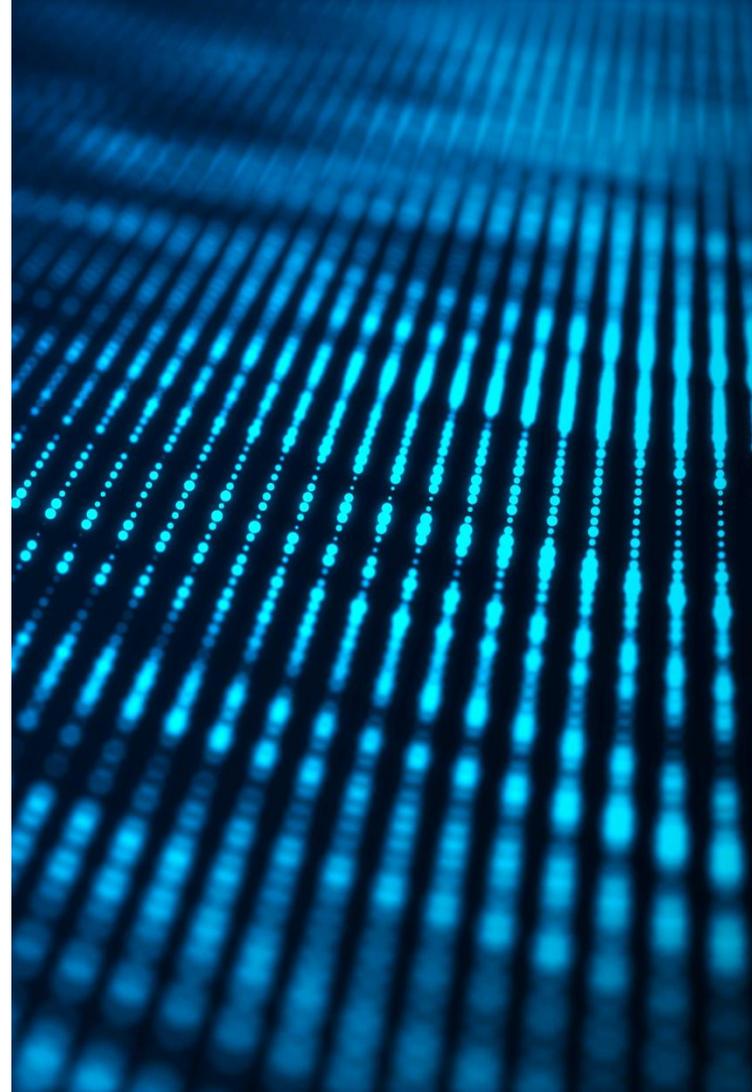
- Section 954(c)(6) was originally enacted as part of the America Jobs Creation Act of 2004. Since then, it has been extended several times, each with a sunset date, the most recent of which was 12/31/25

After OBBBA

- OBBBA permanently extends section 954(c)(6) look-through
- Provides certainty to taxpayers, although many taxpayers had moved to a fully checked structure under a CFC
 - Obviates the need for planning to qualify for the same-country exception for dividends, interest, and royalties
 - Will we now get final regulations under Notice 2007-9?



**Foreign Tax Credit Impacts
Including Expense Allocations
and Source of Income**



Section 904 Foreign Tax Credit Limitation

Net CFC Tested Income Basket

- Under the prior rules, there was no specific allocation rule for the GILTI basket
 - Taxpayers were required to allocate and apportion expenses borne in the US to the GILTI basket, which could result in a permanent loss of FTCs
- Under the new rule, with respect to the “net CFC tested income basket” (formerly the GILTI basket), the taxpayer’s taxable income from foreign sources is determined by allocating and apportioning:
 - (1) any deduction allowed under section 250(a)(1)(B) (section 250 deduction for net CFC tested income and the section 78 gross-up for such income), and
 - (2) any other deduction that is “directly allocable” to such income.
- Similar to the new FDDEI rule, interest expense and R&E expenditures are not allocated to foreign source net CFC tested income.
- Amounts are reallocated to US source income
- Changes likely increase amount of FTCs available in the net CFC tested income basket
 - Consider ripple effects such as ODLs



Section 904 Foreign Tax Credit Limitation

Policy Rationale

- What are the policy explanations and the wider implications for expense allocations?
- Was section 904(b)(5) motivated by a concern to prevent distortions in the foreign tax credit limitation created by overallocation of expenses to foreign source income?
- What are the implications for expense allocation beyond interest and R&E expense?



Section 904 Expense Apportionment Issues

- What are examples of deductions that are directly allocable to NCTI?
 - Is stewardship an expense that is directly allocable to NCTI?
 - How is the government thinking about whether to classify a deduction as “directly allocable” to NCTI?

Section 904 Expense Apportionment Issues

- As noted above, there is a “but for” test in section 904(b)(5) flush language.
 - Treas. Reg. section 1.861-17(b)(1) provides that R&E expenditures ordinarily are considered deductions that are definitely related to “gross intangible income” of the taxpayer and therefore allocable to gross intangible income as a class related to the SIC code and apportioned under the rules of Treas. Reg. 1.861-17.
 - Treas. Reg. section 1.861-17(b)(2) specifically carves out section 951 and 951A inclusions from the definition of gross intangible income.
 - The preambles to the proposed and final regs explain that “subpart F or GILTI inclusions reflect income earned by a CFC and not the taxpayer incurring the R&E expenditures.”
- Thus, it seems that R&E would ordinarily NOT be allocated to NCTI. Accordingly, the “but for” test would not be satisfied to allocate the R&E to US source.
 - N.B. This could be relevant in terms of an amount of an overall domestic loss.

Section 904(b)(6) Source Rule

- Pre-TCJA section 863(b) generally provided for 50/50 US/foreign sourcing with respect to inventory property that was produced within the US and sold outside the US (or vice versa).
- New rule for the purposes of the FTC limitation, income from the sale or exchange outside the US of inventory property,
 - (1) which is produced in the US,
 - (2) which is for use outside the US,
 - (3) to which the third sentence of section 863(b) applies (*i.e.*, is generally sourced to the place of production activities with respect to such property), and
 - (4) which is attributable to an office or other fixed place of business of a US person in a foreign country (determined under the principles of section 864(c)(5) (*e.g.*, such foreign office must be a “material factor” in the production of such income, and such office must regularly carry on activities of the type from which such income is derived)),

is treated as 50% foreign source income.

- This amendment applies to taxable years beginning after December 31, 2025.

Sections 78 and 960

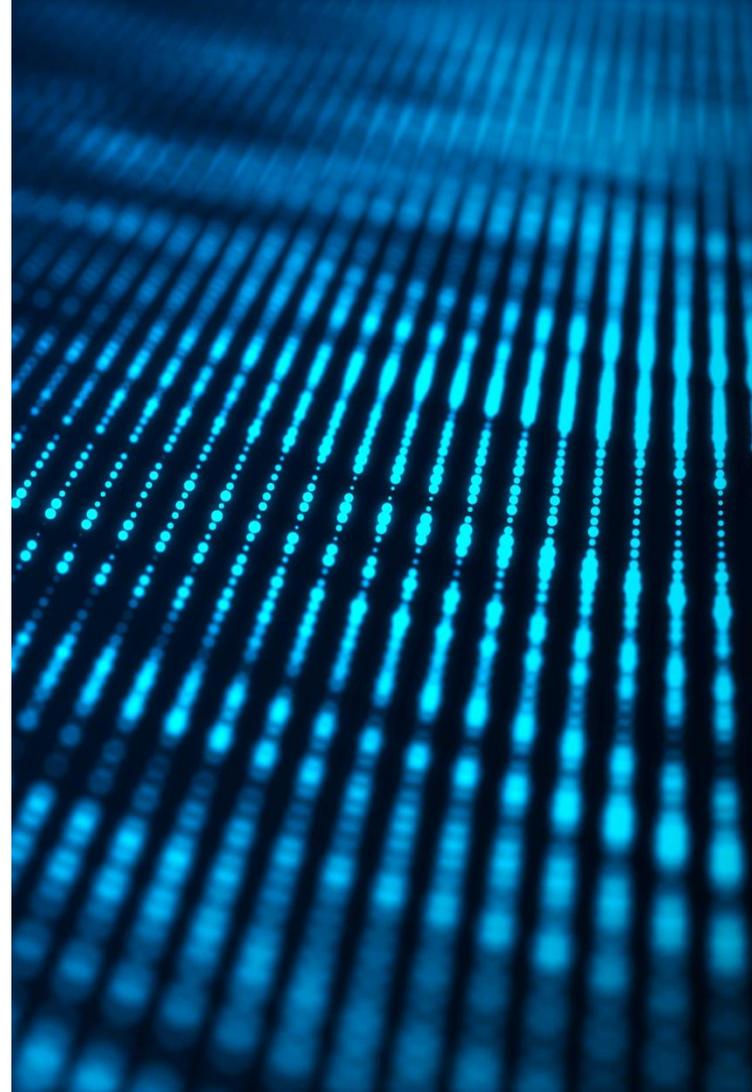
- No section 78 gross-up on distributions of PTEP
 - Applies to taxable years beginning after December 31, 2025.
- New 10% GILTI haircut also applies to foreign taxes paid or deemed paid under section 960
 - No FTC is allowed for the 10%
 - Applies to foreign income taxes paid or accrued with respect to any amount excluded from gross income under section 959(a) (PTEP) by reason of an inclusion in gross income under sec. 951A(a) (GILTI/NCTI) after June 28, 2025
 - Distributions attributable to GILTI/NCTI inclusions occurring after June 28, 2025?
 - Is a calendar year taxpayer's 2025 GILTI inclusion subject to this rule?
- These two provisions result in a mismatch of effective dates with respect to distributions of PTEP out of GILTI/NCTI where
 - depending on the reading of the rule above, PTEP distributions out of GILTI/NCTI inclusion after June 28, 2025 (or longer, depending on the entity's taxable year) are subject to the 10% haircut,
 - while the GILTI haircut reduction and related section 78 reduction from 20% to 10% do not come into effect until 2026 (or a later fiscal year).

Technical Corrections to Section 904

- Amends section 904(d)(2)(H)(i) to provide that tax imposed under the law of a foreign country or possession of the US on an amount which does not constitute income under US tax principles (i.e., a “base difference”) is in the general basket, not the foreign branch basket.
 - This technical fix was required since the TCJA was enacted in 2017 because the base difference rule cross referenced section 904(d)(1) baskets but had an “old” cross reference that was no longer to the general basket due to TCJA’s addition of new baskets (i.e., GILTI and foreign branch).
- Amends section 904(d)(4)(C)(ii) to provide that, if the Secretary determines a taxpayer has not substantiated the proper basket of a dividend, the dividend is allocated to the passive income basket, rather than the net CFC tested income/GILTI basket.
 - Also, an incorrect cross reference left over from prior to the TCJA.
- Amends section 951A(f)(1)(A) to provide that any net CFC tested income included in gross income is treated as subpart F income for purposes of all of section 904(h), rather than only for purposes of section 904(h)(1).
 - Extends the subpart F treatment of net CFC tested income for all parts of the section 904(h) source rules for US-owned foreign corporations.
- Amendments apply to taxable years beginning after December 31, 2025.



Downward Attribution Rule for Stock Ownership



Reinstatement of Section 958(b)(4)

- The TCJA repealed section 958(b)(4) leading to unintended and burdensome consequences for MLCs.
 - The repeal allowed for downward attribution, causing a U.S. subsidiary to be considered the constructive owner of its foreign parent's other foreign subsidiaries.
 - The repeal resulted in many foreign subsidiaries that were not previously classified as CFCs becoming CFCs as a result of the repeal—even when the U.S. parent had no direct or indirect control over them.
- The OBBBA reinstated section 958(b)(4), which limits downward attribution of stock ownership under the controlled foreign corporation (CFC) rules while also adding new section 951B, which applies downward attribution principles in certain cases to more narrowly address the policy concerns that originally drove section 958(b)(4)'s repeal.

New Section 951B

- Under new section 951B, two new classifications are introduced:
 - Foreign Controlled US Shareholder (“FCUS”), and
 - Foreign Controlled Foreign Corporation (“FCFC”).
- A FCUS is defined as a US person who owns, directly, indirectly or constructively, more than 50% of a foreign corporation (as opposed to the usual 10% threshold generally used to define US Shareholders of CFCs), applied as if downward attribution were still permitted.
- A FCFC is a foreign corporation (other than a CFC) where FCUSs own, directly, indirectly or constructively, more than 50% of the stock, applied as if downward attribution were still permitted.
- Section 951B then applies the subpart F and GILTI inclusion rules in a similar manner as with traditional US Shareholders of CFCs, but only to FCUSs and only with respect to their ownership in FCFCs.

Section 951B Issues

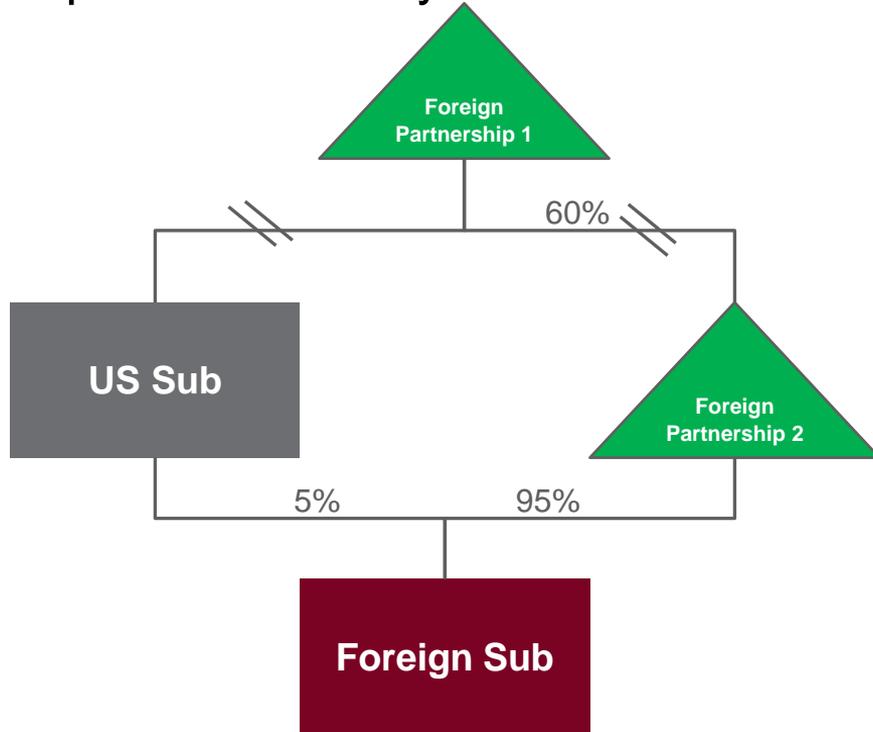
- Section 951B(a)(1) states that for purposes of subpart F (other than sections 951A, 951(b), and 957) “. . . by substituting ‘foreign controlled United States shareholder’ for ‘United States shareholder’” and “by substituting ‘foreign controlled foreign corporation for controlled foreign corporation.’” (Emphasis added).
- Query why section 951B has different wording with respect to section 951A?

Section 951B Issues (Cont'd)

- Section 951B(a)(2) provides that section 951 is applied “by treating each reference to ‘United States shareholder’ in such section as including a reference to such [foreign controlled United States shareholder]” and “by treating each reference to ‘controlled foreign corporation’ in such section as including a reference to such foreign controlled foreign corporation.”
- The substitution of “FCFC” and “FCUSS” for “CFC” and “USS”, respectively, may create anomalies with respect to section 954(c)(6).
- Consider a foreign-parented group where:
 - FP owns USS and FS1, and FP and USS together own FS2. FS1 receives royalty income from FS2. If USS owns 50% of FS2, section 954(c)(6) applies (because both FS2 and FS1 are FCFCs) but if USS owns 51% of FS2, section 954(c)(6) does not apply (because FS2 is a CFC, but FS1 is a FCFC).
- Small changes in an ownership structure can have significant relevance in international tax; query whether this result was intended.

Section 958(b)(4) & Section 951B:

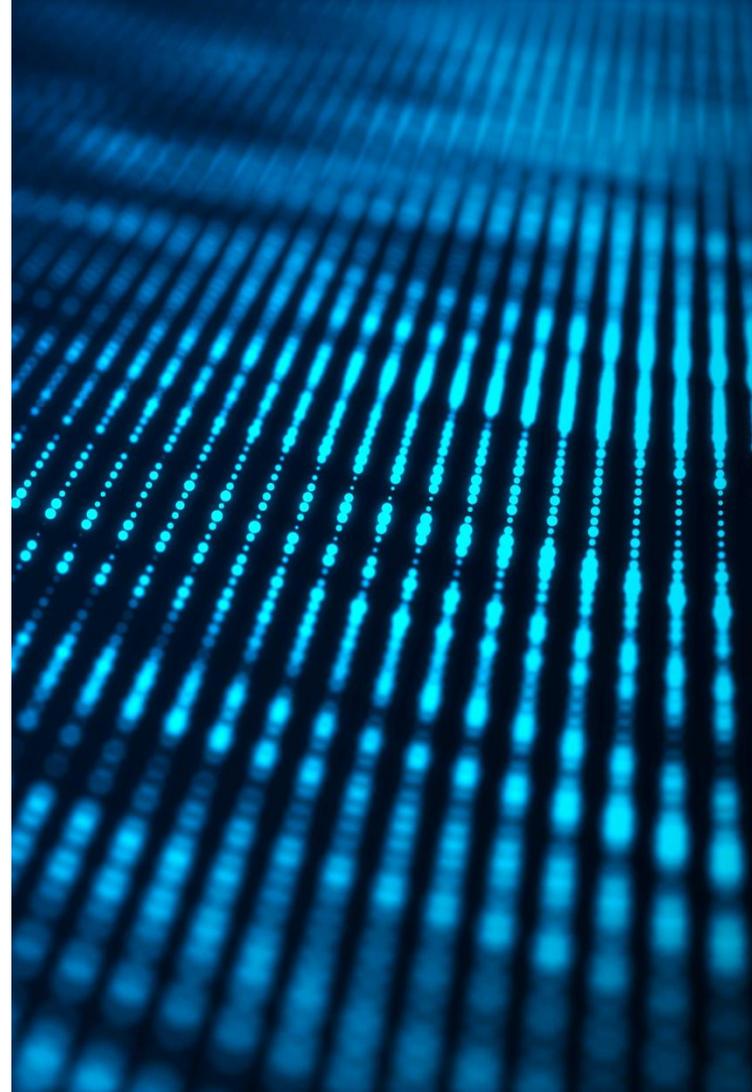
Traps for the Unwary?



- In the context of complex structures, we suspect that section 951B will create traps that even sophisticated taxpayers may find difficult to identify, if only because they lack the information to do so.
- Is there a section 951B risk here?
- Do we think US Sub is aware of the risk?



Pro Rata Share Rule for Deemed Income Inclusions



Pre-OBBA Section 951(a)(2)

- Section 951(a)(2) generally defines a U.S. shareholder's "pro rata share" of a CFC's Subpart F income thereby determining the portion of the CFC's income that the U.S. shareholder must include in their gross income for the tax year.
- **Last-day ownership:** Under prior law, a U.S. shareholder's pro rata share of a CFC's subpart F income was based on their stock ownership on the last day of the CFC's tax year.
- **Example:** A U.S. shareholder who owned CFC stock for only one day—the last day of the year—was responsible for including their pro rata share of the *entire year's* subpart F income. Conversely, a U.S. shareholder who sold their stock on day 364 of the year had no inclusion.
- **Hot Potato Rule:** This "last-day" rule enabled tax planning where CFC stock could be transferred to avoid subpart F inclusions.

New Section 951(a)(2) Pro Rata Share Rules

- For CFC taxable years beginning after December 31, 2025, the OBBBA fundamentally changed the CFC pro rata rules.
- **Any-Day Ownership:** A U.S. shareholder who owns stock (as defined in section 958(a)) at *any point* during a CFC's taxable year must now include their pro rata share of the CFC's subpart F income.
- **Daily Proration:** This new rule eliminates the so-called “hot potato” rule by requiring the U.S. shareholder to include only the income attributable to the period during which they *actually owned* the stock.
- **Transition Rule:** Dividends paid by a CFC shall not be treated as a dividend for purposes of “old” section 951(a)(2)(B) if (among other things): “[the dividend] was paid (or deemed paid) after June 28, 2025, and before such [CFC's] first taxable year beginning after December 31, 2025, and [the dividend] does not increase the taxable income of a United States person”

New Section 951(a)(2): Transition Issues

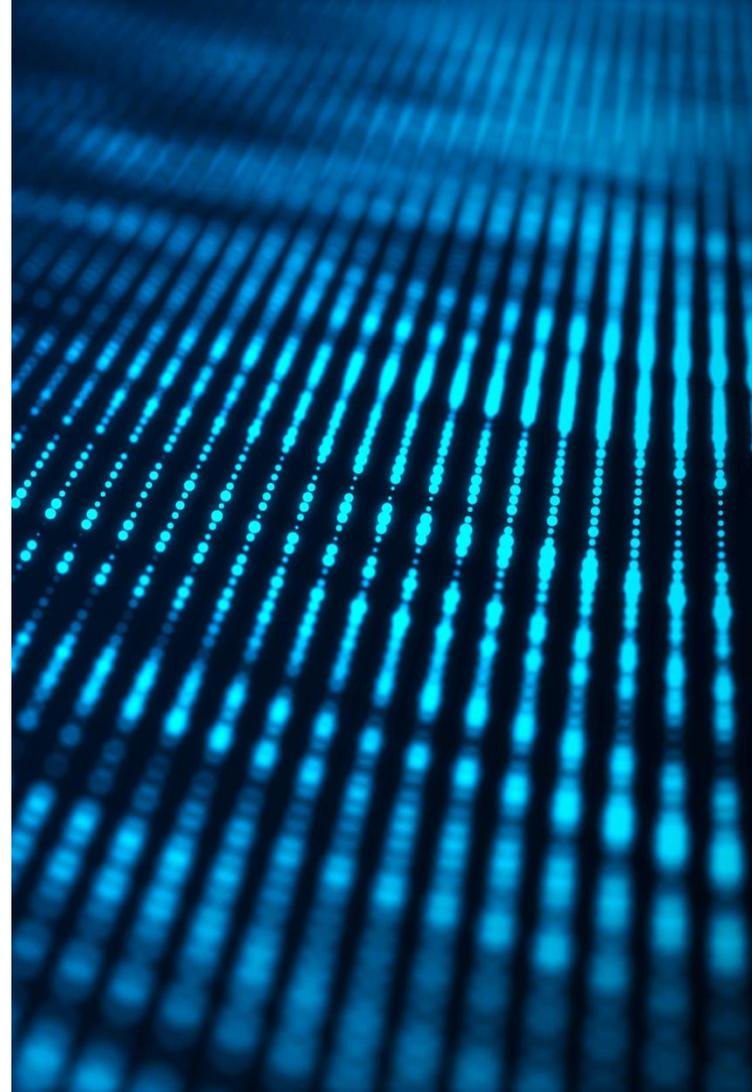
- It is unclear how the transition rule interacts with the extraordinary reduction rules in Treas. Reg. section 1.245A-5(e) and (f) including the closing-of-the-year election?
 - There appears to be some circularity in the case of a sale by a US person to another US person.
 - As an alternative, could taxpayers elect to early adopt the new section 951(a)(2) pro rata share rules?
- For purposes of permissive and mandatory year closes, Treasury has stated that we should expect guidance on these issues
 - Some relevant considerations may include:
 - the percentage (by vote or value) of stock transferred in a CFC;
 - the extent to which transactions are aggregated (by time, plan, or otherwise); and
 - whether the transferee is related or unrelated, domestic or foreign, taxable or nontaxable.
- Are there other Code provisions that might offer analogies? S corporation rules? Extraordinary reduction rules? Former section 708? Others?

New Section 951(a)(2): Additional Transition Issues

- To the extent a transfer does not end a tax year, might Treasury consider issuing limited section 961 guidance to allow mid-year transferors to benefit from basis adjustments attributable to subpart F and GILTI inclusions?
- Under pre-OBBBA law, section 1248 and 951 rules both allocated subpart F, GILTI, and E&P to different periods of a year based on day-count proration, rather than a more complex method.
- Both rules also allocate subpart F, GILTI, and E&P to classes of stock based on a hypothetical distribution; that is, they respect the legal form of a transaction rather than impose an alternative method.
 - Might Treasury consider adopting the general rules of section 1248 (including the rules on increases and decreases to share count) to maintain consistency between those provisions?
 - Query to what extent does Treasury see flaws in a day-count proration, hypothetical dividend, share-count averaging, or other principles of section 1248?



Changes to Small Business Stock under Section 1202



Qualified Small Business Stock

Amended Section 1202



Prior to the OBBBA, investors of qualified small business stock (QSBS) were able to avoid some or all of the gain on the sale of such stock if they held the stock for at least five years.



Many startups and VC-funded companies are qualified small businesses and maintaining that status is critical for sellers of such companies up until they meet the requirements for exempting gain.



Prior to the OBBBA, in some instances, certain selling shareholders would request to defer their sale until they met the five-year holding requirement, or they would want to receive stock in a tax-free transaction, in order to preserve their ability to exempt their gains, leading to complicated acquisition decisions for buyers of such companies.



The OBBBA relaxed some of the QSBS requirements (by allowing larger companies to possibly qualify) and by including partial exemption provisions as long as the QSBS (that is acquired after July 4, 2025) is held for at least three years, reducing the motivation of sellers of qualified small businesses to request complicated sale structures.

03 Pillar Two Update

TAX FROM EVERY ANGLE

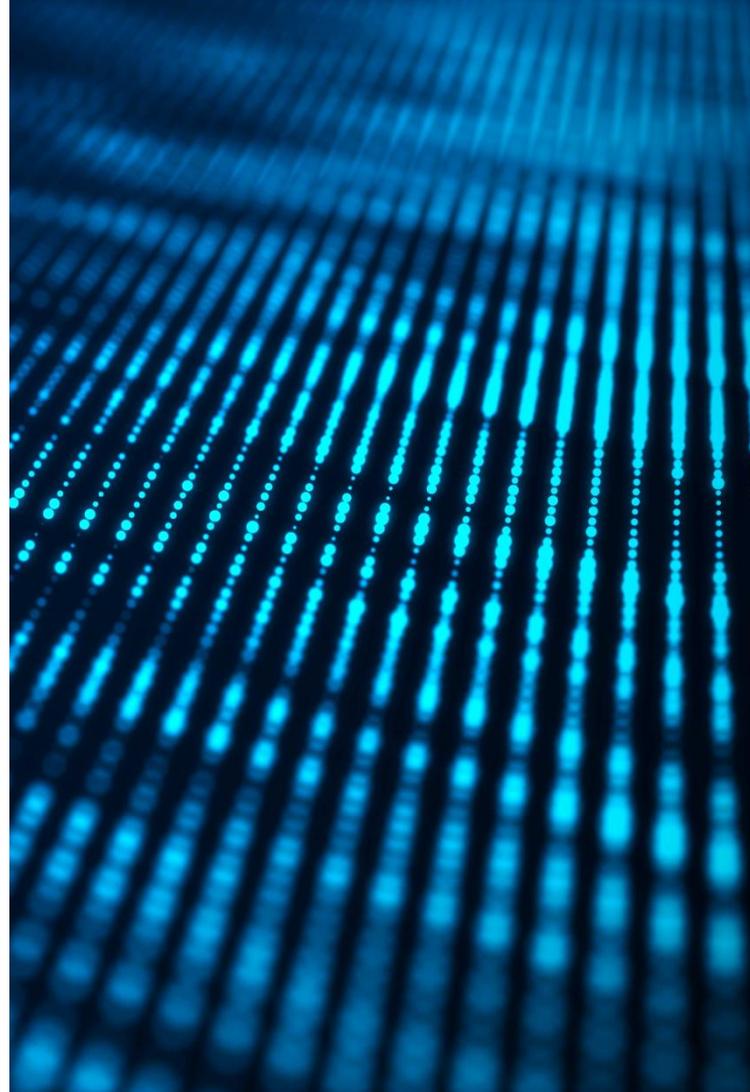


Overview

01 The Possible Pillar Two “Deal”

02 What To Expect in October

03 Pillar Two Implementation in
Asia Pacific



Road to a Possible Global Minimum Tax Deal

- **January 20, 2025** President Trump issued a White House Memorandum providing that Biden Administration commitments "*on behalf of the United States with respect to the "[OECD] Global Tax Deal have no force or effect within the United States absent an act by the Congress adopting the relevant provisions of the Global Tax Deal."*
- **April 11, 2025** At the OECD Inclusive Framework ("IF") meeting in Capetown, South Africa, Deputy Assistant Secretary (International Tax Affairs) stated that at "*a high level, we are seeking agreement that the US system stands side by side with the pillar 2 system."*
- **May 22, 2025** The House passed its version of the One Big Beautiful Bill Act (the "O3B Act") including a new Section 899 (also known as the "Revenge Tax").
- **June 16, 2025** The Senate Finance Committee released its version of the O3B Act with a somewhat less-burdensome version of Section 899 as well as other material changes to international tax provisions.
- **June 26, 2025** In a joint statement, Chairmen Crapo and Smith provided that "*[a]t the request of Secretary Bessent and in light of this joint understanding to preserve US tax sovereignty and allow US tax laws to co-exist with the Pillar 2 regime, we will remove proposed [Section 899], and we look forward to active engagement with Treasury on these important issues."*
- **June 27, 2025** The Senate released an updated version of the O3B Act no longer containing Section 899.
- **June 28, 2025** Canada, on behalf of the Group of Seven ("G7"), issued a joint statement (the "Joint Statement") expressing an "understanding" to work towards a "side-by-side" system. While the OECD Secretary General, Mathias Cormann, issued a statement welcoming the G7's "*breakthrough statement*" and broader engagement with IF members, the director of the OECD's Centre for Tax Policy and Administration, Manal Corwin, stated that the Joint Statement is only "*a starting point for further talks in the inclusive framework."*
- **July 4, 2025** President Trump signs the O3B Act into law. The final version of the O3B Act includes changes to the U.S. international tax rules but without Section 899.
- **August 2025** Bloomberg reports that leaked OECD documents that they reviewed demonstrate significant opposition within the IF membership to a proposed "side-by-side system" as outlined in the Joint Statement.

The G7 Joint Statement

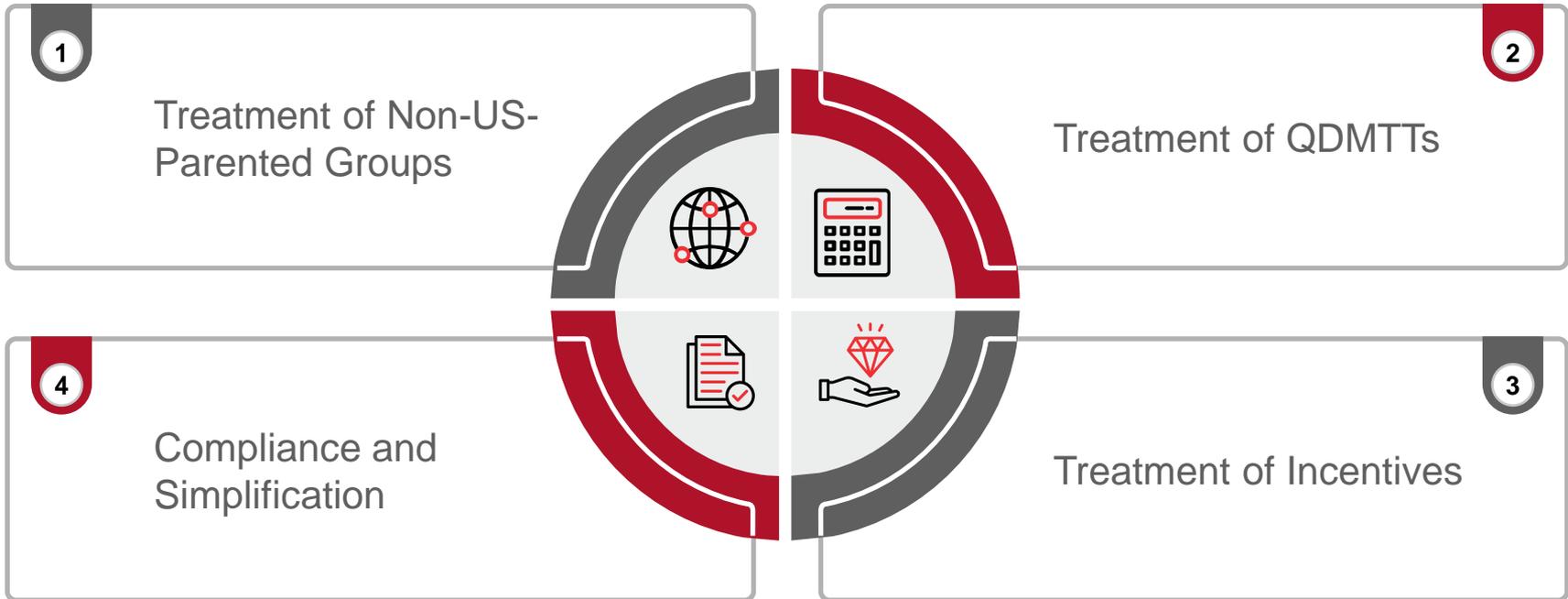


- The Joint Statement provides that the United States and the other IF members will work on a proposed "side-by-side" solution based on the following principles:
 - Fully exclude US-parented groups from the UTPR and the IIR in respect of both their domestic and foreign profits.
 - Include a commitment to ensure any substantial risks that may be identified with respect to the level playing field, or risks of base erosion and profit shifting, are addressed to preserve the common policy objectives of the side-by-side system.
 - Work would be undertaken to ensure material simplifications are delivered to the overall Pillar Two administration and compliance framework.
 - Work would also be undertaken to address the Pillar Two treatment of substance-based non-refundable tax credits that would ensure greater alignment with the treatment of refundable tax credits.

- The G7 is made up of seven countries including Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.*

* N.B. The Presidents of the European Council (António Costa of Portugal) and the European Commission (Ursula Gertrud von der Leyen of Germany) represent the EU at G7 summits.

The Joint Statement Raises Four Key Open Issues





Treatment of Non-US-Parented Groups

- The Joint Statement provides that "[a] side-by-side system would fully exclude US-parented groups from the UTPR and the IIR in respect of both their domestic and foreign profits."
- This would appear to exclude the application of:
 - The UTPR by any other jurisdiction against a US parent's earnings, and
 - The intermediate IIR and the UTPR against the earnings of domestic and foreign subsidiaries of a US parent.
- With respect to a **non-US-parented group**, does either the UTPR or the IIR apply to the earnings of its US subsidiaries (and the earnings of the US subsidiaries' foreign subsidiaries)?
 - Would the US domestic tax system be treated as a QDMTT?
 - If so, would the United States become a popular holding company jurisdiction?
 - Consider the impact of the US anti-inversion and exit-tax regimes.
 - Countries may insist on limiting exclusion to earnings of US subsidiaries to thwart allowing MNEs the ability to select which entities are subject to the GloBE rules and which are subject to the US system.
- Would a side-by-side system create a competitive disadvantage for Non-US-parented companies? Or is the US system sufficiently robust?
- Would such an exclusion be limited to US-parented groups or would other jurisdictions also be eligible if their systems were deemed sufficiently "robust"?



Treatment of QDMTTs

- In the Joint Statement, the G7 members commit "*to ensure any substantial risks that may be identified with respect to the level playing field, or risks of base erosion and profit shifting, are addressed to preserve the common policy objectives of the side-by-side system.*"
- The Joint Statement also provides that an analysis of the two systems took into "*consideration [] the success of [QDMTT] implementation and its impact...*".
- The above quoted language raises several issues that go to the heart of the Pillar Two system's viability.
 - Does such language suggest that jurisdictions with enacted QDMTTs must retain them?
 - Will a side-by-side system require that incentives remain for jurisdictions to retain their QDMTTs?
 - Might some jurisdictions collectively resort to acting outside the Pillar Two system to further reduce the likelihood of jurisdictions repealing their QDMTTs?
 - Does it open the door to hybrid QDMTTs, such as where a jurisdiction's otherwise qualifying DMTT would only apply to local subsidiaries of non-US-parented groups?
- Do the references to a "level playing field" and "common policy objectives" suggest that the blending permitted under the United States' NCTI system is not inconsistent with Pillar Two and does not result in a "substantial risk" that US MNEs have an advantage over foreign MNEs taking the US tax system in its totality?



Treatment of Incentives

- The Joint Statement provides that "**considering** changes to the Pillar [Two] treatment of substance-based non-refundable tax credits that would ensure greater alignment with the treatment of refundable tax credits" will accompany work on the side-by-side system. (Emphasis added).
- Of the four principles in the Joint Statement, this is the only principle that uses the word "considering."
 - This appears to be a tacit acknowledgement that the development of new rules to govern the treatment of incentives under Pillar Two may be a significant challenge upon which to regain consensus among the IF members.
 - A side-by-side system where the United States has no restrictions on the terms of any of its tax incentives while each of the 146 other IF members must ensure that each of its incentives is consistent with the Qualified Refundable Tax Credit ("QRTC") definition in Article 10 of the Model Rules may be hard for the IF to accept.
 - However, if Administrative Guidance can be adopted that provides safe harbors for "good" incentives and anti-abuse rules for "bad" incentives, any advantage US-based MNEs may enjoy may be quite limited.
- Issues that will need to be addressed include whether refundable/nonrefundable distinction should be replaced with (or augmented by) a set of rules focused on incentives requiring **substance/activity** in the relevant jurisdiction as opposed to incentives aiming to attract income to that jurisdiction.



Compliance and Simplification

- The Joint Statement would "[w]ork to deliver... material simplifications... to the overall Pillar [Two] administration and compliance framework."
- Suggests that the G7 is committed to a permanent safe harbor designed to minimize compliance burdens associated with filing GloBE information returns while maintaining the integrity of the Pillar Two system.
- We note that under a side-by-side system, US-parented groups may not have to file a GloBE information return. See next slide for more detail.
 - Some non-US MNEs have publicly raised concerns that a side-by-side system would further disadvantage them vis-a-vis US MNEs.
 - US MNEs have argued that the US tax compliance requirements on US-parented groups are the most burdensome in the world and still do not relieve those groups of their obligations to file returns in most of the local jurisdictions in which they operate.
- It is not clear whether a dispute resolution solution will be part of the OECD/IF efforts to arrive at a side-by-side system. If the United States is no longer part of the Pillar Two system, might it be more realistic for the IF to develop a mandatory dispute resolution instrument—at least with most of the largest remaining economies that have enacted Pillar Two rules?



Compliance and Simplification (Cont'd)

- If US-parented groups are not required to file a GIR, additional issues will need to be addressed.
 - How to allow necessary QDMTT compliance without the GIR?
 - As currently designed, many jurisdictions have drafted bare-bones QDMTT forms and, instead are relying on the sharing of information to be provided by an in-scope MNE on its GIR to determine the MNE's jurisdictional QDMTT liability.
 - Determination of the includable members of groups with US UPEs (e.g., JVs).
 - Depending on the effective date of a “side-by-side” system, how groups with US UPEs report their 2024 and 2025 IIR and UTPR liabilities due to the limited scope and availability of the UTPR safe harbor (only available to protect US earnings from UTPR in 2024)?
 - How to implement retroactively if foreign domestic law needs to change to remove GIR requirement?



Other “Side-by-Side System” Issues

- How will a side-by-side system address differences between the US CFC definition and the GloBE rules relating to, for example, Joint Ventures/Subgroups and Minority-Owned Constituent Entities/Subgroups?
- How will such a side-by-side system address Partially-Owned Parent Entities (or POPEs) where under the GloBE system all the profits of a POPE are subject to potential top-up tax while, under the US system, only 10% US shareholders of a CFC are subject to US tax on their pro rata share of the CFC’s earnings?
- Will a side-by-side system require the US to provide a foreign tax credit for QDMTTs and, if so, will the US be permitted to limit those credits consistent with the US system’s historical limitations (e.g., the foreign tax credit limitation and the separate basket limitations under Section 904).
- How will a side-by-side system address transactions between a QDMTT jurisdiction and a jurisdiction that has that has Constituent Entities that are not subject to the GloBE rules (e.g., transactions between a QDMTT jurisdiction and a US entity where the UPE is also a US entity)?
- How will a side-by-side system address tax attributes of entities under a US UPE when that US UPE is acquired by a Constituent Entity of a UPE that is subject to the GloBE rules?

QDMTT Implications & Possible Strategic Responses

- If QDMTTs remain relevant – what does it mean for US MNEs despite the side-by-side deal?
 - Jurisdictional exits – Will US MNEs explore exiting QDMTT jurisdictions?
 - Will there be a jurisdictional shift of financing hubs?
 - Are mitigation strategies still viable where exit isn't feasible?
 - Are anti-avoidance concerns easier to manage in a side-by-side world?
- **Asset values** - Uncertainties in the side-by-side deal
 - How will US assets be valued for Pillar Two purposes?
 - Is US asset value still relevant for MNEs?





What to Expect as the Pillar Two Negotiations Move into October

- Unclear how the Pillar Two negotiations are progressing, but US is insisting that the IF arrive at a consensus framework on a side-by-side system by the end of October.
- Truncated timeline makes the next few weeks critical to whether a deal is in the offing.
- China and India may represent significant hurdles as they are not likely to enact any GloBE rules, and it is hard to imagine they will be comfortable giving US MNEs an exemption from the Pillar Two system while subjecting their MNEs to Pillar Two taxes.
- The European Union may struggle to reach consensus among its members on a raft of US-favorable proposed changes to the system in part over fears of the playing field tilting in favor of US-parented groups.
- In light of the current instability of the global economy (including the uncertainty surrounding the Trump Administration's imposition of tariffs on critical members of the Inclusive Framework), we should not be surprised if the negotiations extend into 2026.
- Query whether, if no deal as the calendar turns to late October/early November, US Treasury dual tracks by commencing with a negotiation to extend and expand the current UTPR safe harbor to provide some additional breathing room to ensure a durable and widely accepted agreement on a side-by-side system is concluded.
- What role, if any, does section 899 play?

Are We Seeing Pillar Two Influence M&A?

- Pillar Two has not yet become a “standard” issue on M&A deals.
- But why is that, given that the rules are now enacted in many countries and are soon to be effective?
 - Uncertainty about the US tax overlay, patchwork of domestic law implementation, ongoing changes to the OECD guidance and existing domestic legislation.
 - Practitioners still coming to grips with the rules and no “market standard” has emerged.
 - W&I insurance market still digesting.
 - Groups still grappling with their own Pillar Two position (i.e., modelling, compliance, planning).
- That said, we are seeing Pillar Two:
 - Become a factor influencing deal structures (i.e., share deals vs asset deals).
 - Impact certain other aspects of the contractual terms agreed between buyer and seller on M&A deals.

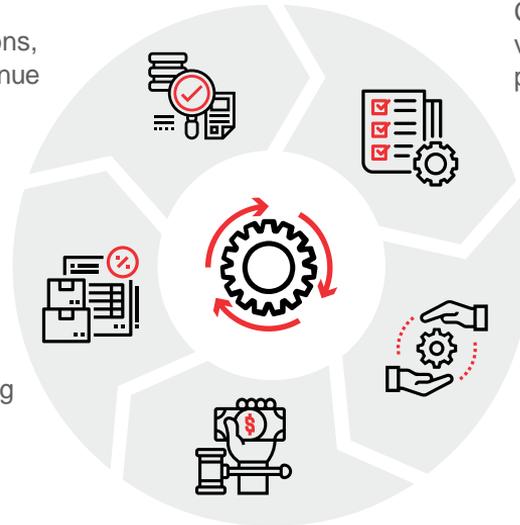
Pillar Two Throughout the Transaction Life Cycle

Review of the Target Group Tax Structure

Both as part of due diligence to analyze GloBE ETR and potential top-up tax implications, and impact on reaching the consolidated revenue threshold

Pillar Two Planning Post-Acquisition

Post-acquisition cooperation in light of Pillar Two multi-jurisdictional dispute, rationalization of legal structure, tax modelling



Tax Compliance Matters

Including GloBE reporting and other tax disclosures

Transaction Planning

Choice of deal structure and of acquisition vehicle, deal value, acquisition financing, pre-acquisition restructurings

Acquisition Phase

Pillar Two specific contractual tax protections, W&I, secondary tax liability clause, co-operation post-completion in case of Pillar Two dispute

04 Inversions Revisited



U.S. MNE Expatriations: Potential Tax-Related Benefits and Burdens

■ Potential Benefits

- Reduce U.S. CFC-related taxes (i.e., NCTI and subpart F income) and related compliance.
- Reduce U.S. taxable income through intercompany debt and royalty arrangements.
- Reduce U.S. taxable income tax by transferring assets (e.g., intellectual property) out-from-under U.S. parent to underneath new foreign parent.
- Grow business outside the United States without subjecting future income to U.S. income tax.
- **Reduce risk of subjecting business to taxpayer-unfavorable U.S. legislative and regulatory uncertainty.**

■ Potential Burdens

- May be subject to Pillar Two taxes and related compliance.
- May be subject to both U.S. and Pillar Two tax systems if section 7874(b) 80% anti-inversion rules apply.
- Consider loss of expensing of R&D/PPE, FIDDEI, and other U.S. incentives vs. new “Topco” jurisdiction’s incentives.
- Possibly subject MNEs to additional penalties including loss of lower dividend rate for U.S. individual shareholders, reduced ability to benefit in post-inversion restructuring, and expanded BEAT payment definition to include COGS.



U.S. MNE Expatriations: Potential Non-Tax-Related Benefits and Burdens

■ Potential Benefits

- Potentially more favorable industry-relevant regulations.
- Achieving foreign private issuer status for U.S. securities law purposes.
- Proximity to essential natural resources.
- The experience and relative costs of the local (or nearby) labor force.
- Possible reputational benefits/brand enhancement.
- Proximity to key customers.
- Potentially more favorable industry-relevant regulations.
- Reduced risk of U.S. government interference (see e.g., Intel, Nvidia, and Nippon Steel).

■ Potential Burdens

- **Heightened exposure to U.S. tariffs.**
- Reduced access to the deep U.S. equity and credit markets.
- If to European Union jurisdiction, increased exposure to heightened EU regulatory environment.



Non-U.S. MNE Expatriations/Reversions to US: Potential Benefits and Burdens

■ Potential Benefits

- Depending on final terms of the Inclusive Framework "side-by-side system" negotiations, avoid some Pillar Two taxes and some related compliance burdens.
- Greater access to deep U.S. equity and debt markets.
- Improve regulatory environment (depending on foreign parent jurisdiction).
- Possible closer proximity to suppliers or customer base.
- Access to advanced and experienced work force.
- Reduced exposure to U.S. tariffs for sales to U.S. market.

■ Potential Burdens

- Subject to U.S. tax on MNE's worldwide income and related outbound compliance burdens.
- **Inability to expatriate in the event the U.S. business/tax climate worsens.**
- Consider loss of current jurisdiction's tax incentives vs. U.S. tax incentives.
- Worse regulatory environment (depending on foreign parent jurisdiction).
- Potentially weaker rule of law/less political/social stability as U.S. political outlook remains cloudy.



Legislative History: Two Schools of Thought

- **Level the Playing Field**

- Believed United States at a Competitive Disadvantage
- Supported Dividend-Exemption System
- Concern Over Increase in Foreign Takeovers of U.S. MNEs
- Proposed a Reduction in Corporate Tax Rate + Move to (Partial) Territorial System

- **Toll Charge/Deny Tax Exit Visa**

- Believed Competitiveness Argument Inaccurate
- Believed Dividend-Exemption System Would Not Increase U.S. Exports
- U.S. FTC System Sufficiently Generous
- Still Incentive to Reduce U.S. Source Income via Intercompany Transactions

Pre-Section 7874 Limitations on Expatriation

- In 1994, Treas. Reg. section 1.367(a)-3(c) was issued to make an expatriation transaction taxable at the shareholder or corporate level unless certain exceptions are otherwise applicable.
- For a shareholder-level expatriation to qualify for nonrecognition treatment under -3(c), among other requirements, the foreign acquiring corporation must be larger than the U.S. target.
- Other Limitations
 - Section 367(e): Restricts expatriations by turning off sections 355(c) or 361(c) in an outbound section 355-qualifying distribution and section 337 in an outbound section 332 liquidation. See also Treas. Reg. section 1.367(b)-5.
 - Section 269B: Treats a foreign corporation stapled to a domestic corporation as a domestic corporation.
 - Section 1248(i): Recharacterizes internal inversion of USP rendering CFC new parent as a dividend from CFC to USP to the extent of CFC's E&P.

“You can check out any time
you like, but you can never
leave.” – Section 7874(b)



Section 7874 – 80% Inversion

- In October 2004, section 7874 was enacted to limit expatriation transactions.
- In general, if the following three requirements are met, then a non-U.S. incorporated entity will be treated as a domestic corporation for all U.S. federal income tax purposes:
 - Foreign corporation acquires substantially all of the properties of a domestic corporation;
 - Former shareholders of domestic corporation hold at least 80 percent (by vote or value) of stock of such foreign corporation after the transaction by reason of having held equity interests in the domestic entity; **and**
 - Foreign corporation and its expanded affiliated group (“EAG”) do not have substantial business activities (“SBA”) in its country of incorporation.
- Similar rules apply for acquisitions of properties of domestic partnerships.

Section 7874 – 60% Inversion

- Same as 80% inversion substituting “60 percent” for “80 percent” in the ownership percentage, the foreign acquiring corporation will remain a “foreign corporation” for U.S. tax purposes.
- If a 60% inversion, for the post-inversion 10-year period, DT is not permitted to use certain tax attributes (e.g., net operating losses) to reduce the U.S. federal income tax liability attributable to “inversion gains.”
 - Inversion gain is (i) income or gain recognized on the transfer of stock or other properties by an expatriated entity and (ii) income received or accrued by reason of a license of any property by an expatriated entity.
 - Inversion gain does not include income from the transfer or license of inventory to a foreign related person unless the transfer or license was part of the inversion transaction.

Survey of OECD Country Residency Tests

Country	Exit Tax	Exit Tax Rate	Part. Exempt.	G/C Part. Exempt. Rate
Australia	Yes	30% or 25% (connected entities with < AUS 50 mil in turnover)	Yes	100%
Canada	Yes	15% (standard rate applied to 50% of gains) + 25% (departure tax)	Yes	50%
France	Yes	33–34%	Yes	88%
Germany	Yes	22.825–32.825%	Yes	95%
Ireland	Yes	12.5% (standard) or 33% (anti-abuse)	Yes	100%
Italy	Yes	27.9%	Yes	95%
Luxembourg	Yes	24.94–28.69%	Yes	100%
Mexico	Yes	30%	Yes (Div.)	N/A
Netherlands	Yes	15% up to EUR 395,000 25.8% exceeding EUR 395,000	Yes	100%
Spain	Yes	25%	Yes	95%
Switzerland	Yes	7.8% (effective, flat rate of 8.5%)	Yes	100%
United Kingdom	Yes	20%	Yes	100%
Brazil, China, India	N/A	N/A	N/A	N/A

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Questions

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