Tax Strategy & Benefits

Newsletter — Spring 2020

Contents

Summary

Change in tax principles and law, domestically and abroad, continues to unfold at an unrelenting pace. In tax, change matters. This newsletter explores some of the issues and trends that are emerging as a result.

We start by outlining the ambitious fiscal plans of Spain's new coalition government, including its embrace of a unilateral digital services tax (DST) intended to tax revenues of non-Spanish tech companies with no (or little) physical presence in Spain.

The introduction of DSTs around the world (albeit, most noticeably across Europe) has upset the US, which generally considers them to discriminate against the major (mainly US-based) technology companies. However, the US introduced its own attempts to protect its tax base as part of its 2017 Tax Reform package. We examine the Final Base Erosion and Anti-abuse Tax (BEAT) Regulations that ensure certain corporations pay a minimum rate of tax on payments to non-US related parties.

In the section on the Organisation for Economic Co-operation and Development (OECD), we provide an update on its progress in attempting to reach a consensus-based, long-term solution for the tax challenges arising from the digitalization of the economy. Its work, based around a Two-Pillar approach, rolls on with a renewed commitment to find an agreement by the end of 2020.

In Europe, a new European Commission, under the leadership of President Ursula von der Leyen, has commenced its five-year term. The European Commission has set out an ambitious tax policy agenda for its (post-Brexit) 27 member states, which has conspicuously been constructed around climate (and tax) sustainability. We consider the contents of that agenda and the prospects for its implementation.

Finally, we consider tax as part of the "bigger picture," touching on some of the global issues where tax policy has recently become headline news. We discuss international free trade agreements, including the possible impact of UK domestic policies (including some relating to tax) on post-Brexit negotiations with the US and the effect of the French government's unilateral implementation of a DST, alongside some broader transatlantic trade tensions.

SPAIN:
Tax Reform Proposals

On December 30, 2019, the newly elected government, formed by the Socialist Party and left wing *Unidas Podemos*, released its governing agreement. The agreement contained a set of different tax proposals, which will act as the basis for the next Spanish budget bill that the government will raise to Parliament. The proposals are based on a series of broad principles (outlined below), but currently lack significant detail.

It is important to note that, for the time being at least, it is still uncertain if and when these proposals will be put into effect, as the government needs to seek approval to implement them from a still fragmented Parliament.

Crack Down on Tax Fraud

The new government intends to approve a law on measures to prevent and combat tax fraud. The government will draw up a national strategy against tax fraud, e.g., updating the list of tax havens, banning tax amnesties or tightening limits for cash payments.

The government also announced new control measures on collective investment funds (SICAVs) in order to ensure their nature as collective investment vehicles.

Increasing the Progressiveness of the Tax System

The new government intends to increase income taxes for large companies and high-earning individuals. Moreover, it is committed to reviewing the taxation of high-net-worth individuals.

- **Corporate Income Tax**

  The agreement contains several noteworthy proposals related to the Corporate Income Tax (CIT) law, including:

  - A minimum tax rate of 15% would be introduced for large companies (18% for financial institutions and oil and gas companies).

    The minimum tax rate shall apply for companies with an annual turnover of at least €20 million or, in any case, when they are part of a consolidated group. Spanish subsidiaries of multinationals groups would also fall under the scope of the minimum tax, but only where their effective tax rate is lower than 15% due to the application of deductions against the tax payable.

  - Amendment of the "participation exemption" regime.

    One of the most relevant measures (alongside the minimum tax proposal) is the amendment of the "participation exemption" regime for dividends and capital gains to a partial exemption system.

    Currently, the CIT law provides for a full participation exemption for domestic and foreign dividends/capital gains derived by Spanish holdings, provided certain requirements are met. The government has agreed to reduce the exemption to 95%. Therefore, dividends and capital gains will be taxed at an effective rate of 1.25%.

  - Reduction of CIT rate applicable to small and medium-sized enterprises (SMEs).

    The CIT rate for SMEs would be reduced to 23% (from 25%).

- **Personal Income Tax**

  The agreement also contains important changes to the Personal Income Tax (PIT) law, including:

  - PIT rates for employment income will be increase 2% for individuals with an annual income in excess of €130,000 (up to 47%) and 4% for those with incomes in excess of €300,000 (up to 49%).

  - PIT rates for savings income would be increase 4% for individuals with annual saving incomes income (i.e., dividends, interest and capital gains) above €140,000 from 23% to 27%.

Adapt the Current Tax System to the 21st Century Economy

Potentially, the most (internationally) explosive proposal in the agreement is the government's intention to implement a digital services tax (DST, or so-called "Google tax"). The DST proposal is in addition to a tax on financial transactions (an FTT, or so-called "Tobin tax"), as well as a new environmental tax.

In VAT, the government proposes to reduce the rate applicable to sales of veterinary services and feminine hygiene products to 4%.

Changes to the Taxation of Spanish REITs (SOCIMIs)

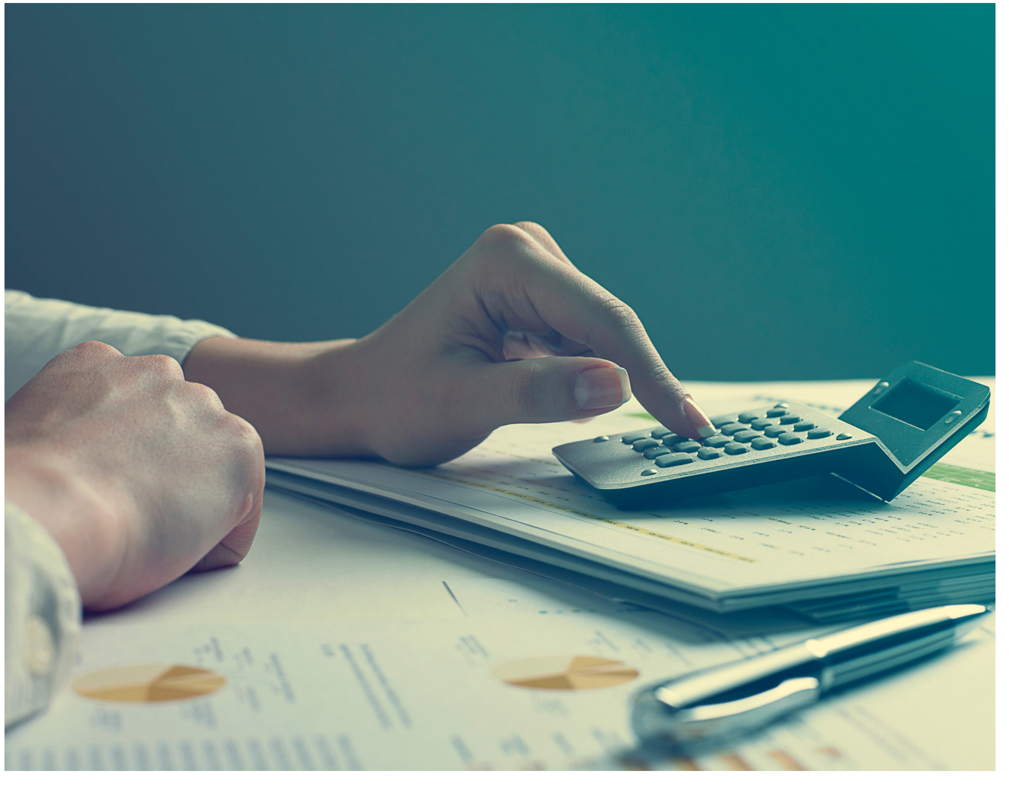
The Spanish government has proposed significant changes to the country's SOCIMIs regime, including, in particular, a 15% tax to be imposed on undistributed benefits.

UNITED STATES:
The Final BEAT Regulations

On December 6, 2019, the Treasury Department (Treasury) and Internal Revenue Service (IRS) issued final base erosion and anti-abuse tax (BEAT) regulations. The final regulations largely adopt the 2018 proposed regulations, with certain modifications.

In response to comments received on the 2018 proposed regulations, Treasury and the IRS also issued, on December 6, 2019, new proposed regulations to provide guidance on certain aspects of the BEAT not addressed by the final rules (2019 proposed regulations).

We have summarized below how the final regulations revise or clarify the 2018 proposed regulations (which we previously discussed in And the BEAT Goes On), and note areas in which the 2019 proposed regulations provide additional guidance.



Overview of BEAT

BEAT is an additional tax that applies only to Applicable Taxpayers, defined as corporate taxpayers that meet both a Gross Receipts Test and a Base Erosion Percentage Test. Once caught by the two tests, an Applicable Taxpayer must determine whether its minimum tax liability for BEAT purposes (i.e., modified taxable income multiplied by the applicable BEAT rate) exceeds its regular tax liability, adjusted to disallow certain credits. The excess, if any, is the taxpayer's BEAT liability.

Overview of Proposed and Final Regulations

In general, the final regulations adopt and modify the rules for determining the status of an Applicable Taxpayer for BEAT purposes, including rules relating to the Gross Receipts Test, Base Erosion Percentage Test and the determination of the aggregate group for purposes of applying these tests.

In particular, the final regulations adopt the "with-or-within method" to determine the gross receipts and the base erosion percentage of an aggregate group. That is, the determination is made on the basis of the taxpayer's tax year and the tax year of each member of its aggregate group that ends with or within the applicable taxpayer's tax year.

The 2019 proposed regulations further address the implementation of this method and other aggregate group rules. For example, transactions between parties are disregarded in determining the gross receipts and base erosion percentage of an aggregate group if both parties were members of the aggregate group at the time of the transaction. In determining the base erosion percentage of an aggregate group, the final regulations exclude the base erosion tax benefits and deductions attributable to the tax year of a member of the aggregate group that begins before January 1, 2018 (the effective date of the BEAT rules).

Highlights of the Final Regulations

The final regulations adopt and modify the rules for determining whether a payment or accrual gives rise to a base erosion payment and the base erosion tax benefits that arise from base erosion payments.

The final rules generally retain the approach in the proposed regulations that the amount of a base erosion payment is determined on a gross basis, except as provided in the BEAT netting rule.

The final regulations provide numerous clarifications and revisions on the base erosion payment. Ten of the key points include:

- The definition of a base erosion payment is clarified to provide that a loss realized from the form of consideration provided to the foreign related party is not itself a base erosion payment.
- Payments resulting in a reduction to determine gross income are not treated as base erosion payments.
- The determination of whether a payment or accrual is a base erosion payment is made under general US federal income tax law.
- Amounts transferred to, or exchanged with, a foreign related party in certain corporate non-recognition transactions are excluded from the definition of a base erosion payment.
- Rules for determining the portion of US branch interest paid to foreign related parties are clarified.
- The treatment of an interest expense determined in accordance with a US tax treaty is clarified.
- Additional detail is provided on the documentation required to satisfy the service cost method exception.
- Section 988 losses with respect to transactions with foreign related parties that are excluded from the numerator of the base erosion percentage continue to be excluded from the denominator.
- The total loss-absorbing capacity exception is modified and clarified.
- Special rules related to insurance companies are adopted and clarified.

The final regulations also adopt and clarify the rules for determining modified taxable income, calculation of Base Erosion Minimum Tax Amount and the BEAT rate. In this regard, the final regulations provide for two significant changes from the 2018 proposed regulations:

- The additional 1% add-on to the BEAT rate will not apply to a taxpayer that is part of an affiliated group with *de minimis* banking and securities dealer activities.
- Section 15 applies only to the change in tax rate set forth in Section 59A(b)(2) and should not apply to the change in tax rate included in Section 59A(b)(1)(A) for tax years beginning in calendar year 2018.

Not neatly fitting into any specific category of changes, the final regulations also contain four miscellaneous modifications from the 2018 proposed regulations:

- The final rules adopt and clarify the qualified derivative payments (QDP) exception.
- The final regulations adopt and clarify the rules for the treatment of partnerships and their partners for BEAT purposes.
- The final regulations adopt and clarify the anti-abuse rule.
- Rules are provided for the application of the BEAT with respect to limitations on certain capital losses and excess credits, consolidated groups and their members, and reporting requirements, which include submitting, in certain cases, new Form 8991 – Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts.

In acknowledgment of the sheer volume and complexity of rules released in such a short time period, Treasury and the IRS have provided taxpayers some flexibility with respect to the applicability dates of the various sets of regulations. The 2019 Final Regulations (other than the reporting requirements for QDPs) are effective for tax years ending on or after December 17, 2018; however, taxpayers may elect to apply them (in whole but not in part) to taxable years beginning after December 31, 2017 and ending before December 17, 2018. Additionally, taxpayers may choose to apply the 2019 proposed regulations to taxable periods beginning after December 17, 2017, as long as the taxpayer and all related parties apply them consistently to all taxable years that end before they are finalized.

Looking Ahead

While some taxpayer advocates may be disappointed by certain narrow aspects of the final regulations and the 2019 proposed regulations (e.g., in the calculation of "taxable income," NOLs cannot be used to generate a negative modified taxable income, or, in determining base erosion payments, an exception was not provided for amounts included in subpart F income or Global Intangible Low-Taxed Income), taken together, the package of regulations generally resolved open issues and provided options that are taxpayer friendly.

Led by Ron Wyden (D-Ore.), Senate Finance Committee Democrats recently wrote a letter to Treasury and the Office of Management and Budget (OMB) expressing their displeasure with what they see as a "greater windfall" for corporations in the final regulations than contemplated by the original bill. In April 2018, the Office of Information and Regulatory Affairs (OIRA), within the OMB, gained authority over tax regulations, thereby allowing companies and lobbyists to meet directly with the officials reviewing and signing off on final regulations. The Senate Finance Committee Democrats have asked Treasury and the OMB to provide details of all meetings between lobbyists and senior officials in the time leading up to the release of the final international regulations (of which BEAT is a significant part), including an analysis of how regulatory decisions help or harm specific companies and the overall impact on federal revenue.

On the heels of this insinuation from the Democrats that lobbyists exerted improper influence on the BEAT regulations, come the Democratic presidential primaries, with every major candidate characterizing the 2017 Tax Cuts and Jobs Act, in part, as a giveaway to corporations. As 2020 progresses and the presidential election nears, we should expect to hear more explicit plans from the Democrats on how exactly the BEAT regulations should be revised to ensure corporations pay their "fair share" and how the lobbying and legislative process can be "cleaned up" to reduce the perceived outsized influence of corporations in the regulatory process.

OECD:
An Update on the Two-Pillar Approach

The OECD's Inclusive Framework on BEPS (base erosion and profit sharing), which now includes 137 countries, is continuing its efforts to find consensus on proposals to address the tax challenges of the digitalization of the economy. The program of work that has been approved by the G20 in this regard would involve changes, in certain circumstances, to well-established principles underlying the taxation of multinational business income.

The program of work is split into two Pillars. The first set of proposals, grouped under Pillar One (which we have discussed in more detail in Pillar of Salt?), would address tax nexus and profit allocation issues by departing from established principles of physical presence and arm's length pricing. The second set of proposals, known as Pillar Two (which we have discussed in more detail in Digitalization of the Global Economy), would establish a global minimum tax regime that could be implemented by all of the Inclusive Framework's member countries.

Pillar One: Tax Nexus and Profit Allocation

The Pillar One proposals include not only new rules for tax nexus and formulaic allocation of global profit among the countries where a multinational group has customers, but also new rules establishing fixed profit margins for baseline distribution and marketing activities in a country, and new rules relating to tax dispute prevention and resolution.

In early December 2019, US Treasury Secretary Stephen Mnuchin sent a letter to the OECD Secretary-General expressing misgivings about the Pillar One proposals' mandatory departures from established international tax principles, and stating that the US would prefer a "safe-harbor approach" (meaning, an elective approach) to new nexus and profit allocation rules. At the same time, the US Trade Representative announced that he was considering imposing tariffs on French goods in retaliation for the French imposition of DST on US multinationals.

At the meeting of the World Economic Forum in Davos, Switzerland, in mid-January 2020, Secretary Mnuchin and French Finance Minister Bruno LeMaire reached agreement on a one-year ceasefire agreement under which the US agreed not to impose tariffs on French imports, and France agreed not to collect DST tax from US companies. Both parties expressed renewed commitment to finding a consensus solution to the taxation of digitalized business through the OECD's Inclusive Framework process.

The Inclusive Framework met in Paris on January 29-30, 2020, and approved a revised program of work, contained in a short 30-page document. A number of points are worthy of note:

- **Timing: The Goalposts Have Been Moved**

  The revised program of work makes it clear that the Inclusive Framework countries have not yet committed to anything beyond using the proposed unified approach (with Amounts A, B and C) as a "basis for negotiations" on a without-prejudice basis and "affirm their commitment to reach an agreement on a consensus-based solution by the end of 2020." This represents a slippage of almost a whole year in comparison to the original timeline (announced a year ago), which had envisaged that agreement on the design of the solution would have been by now reached, with technical details to be worked out and delivered to the G20 by the end of 2020.

  The revised timescale aims to agree the "key policy features of the solution which would form the basis for a political agreement" at its plenary meeting in early July 2020. Working party meetings, addressing eleven different work streams, will go on until November 2020, at least. The relative lack of technical progress suggests that it would be prudent to expect the work to continue well into 2021.

- **The US's Safe-Harbor Proposal Will Be Considered**

  The revised program of work states that "many IF members" are concerned about the US proposal for the Pillar One rules to be elective rather than mandatory. Considering the surprise that greeted Secretary Mnuchin's letter, it is noteworthy that the Inclusive Framework has not dismissed the suggestion as a non-starter. Indeed, the content of the revised program of work implies that some IF members may be in favor of the proposal. However, even if agreement is reached on the US proposal, a host of other important design issues will still need to be dealt with.

- **Relevant Unilateral Actions Have To Be Withdrawn**

  The revised program of work explicitly says that a commitment to the consensus-based solution means a concurrent commitment to withdraw "relevant unilateral measures." This, presumably covers the actual or proposed implementation of any DST (e.g., by France, Spain or the UK); although, the scope and relevance of this statement needs to be defined more clearly at some point in the future.

- **The Scope of the 'Amount A' Rules Has Been Clarified**

  Two categories of businesses are in scope for Amount A, namely, (a) automated digital services (broadly, internet-based businesses), and (b) consumer-facing businesses. Professional services, extractive industries "and other producers and sellers of raw materials and commodities," and regulated financial services are explicitly excluded.

- **Dispute Resolution Processes**

  In light of relatively widespread reluctance over mandatory binding arbitration, new and alternative dispute resolution processes are being discussed. Little detail is provided in the revised program of work, but it is clear that nothing has yet been decided and much more needs to be done. Making progress in this area is, perhaps, the most important workstream of all.

Although some progress has been made, a number of significant design characteristics under Pillar One remain vague. These include key issues such as the method for determining the profits to be re-allocated to market jurisdictions and the method for identifying the jurisdictions from which those profits should be taken. In addition, many developing countries will insist that the Pillar One regime include new rules requiring local reporting of a fixed taxable return on routine distribution activities (Amount B, in the proposed unified approach).

Pillar Two: The GloBE

With respect to Pillar Two, it still appears likely that the Inclusive Framework will have to grapple not only with agreeing on a minimum effective rate of tax, but also with differences of opinion on how the proposed income-inclusion and undertaxed-payments rules should interact. Developing countries want the undertaxed-payments rule to take precedence, whereas developed countries favor making the income-inclusion rule the primary one. This fundamental question will need to be resolved if the Pillar Two work is to mean anything other than an exploration of the different types of anti-base erosion measures that countries are free to adopt if they wish.

The revised program of work merely provides a brief update on Pillar Two to confirm that the design work is ongoing. It is clear that the main issues have yet to be resolved. However, it is interesting to note that nowhere in the 30-page revised program of work is there an assertion of the proposition that Pillar One and Pillar Two should be adopted as a package in any final consensus-based solution.

It is likely that a public consultation paper will be issued in March or April 2020, requesting comments on issues relating to the undertaxed-payments rule and perhaps other elements of Pillar Two as well.

Engagement

Multinationals will be well advised to engage with policymakers on these issues. Many of the comments made by business representatives on the consultation papers issued in 2019 appear to have been influential. It is noticeable, and most welcome, that the OECD (which in the past, did its tax policy work without the benefit of much input from the multinational business community) has become more interested in listening to taxpayers' suggestions.

EUROPEAN UNION: New Commission, New Tax Agenda

After a relatively turbulent start, the Ursula von der Leyen (VDL) Commission formally started a new five-year political mandate of the European Commission (Commission), the European Union's (EU) executive body, on December 1, 2019.

The VDL Commission intends to be a "geopolitical Commission," building on the work of the previous "political Commission" led by Jean-Claude Juncker. The geostrategic focus of the new EU Commission underlines the desire to increase Europe's assertiveness at the global level, and is visible in many elements of the priorities and suggested new measures of the VDL team, including those in the field of taxation.

The VDL Commission

The hierarchical structure proposed by VDL differs from the structure of the former Jean-Claude Juncker Commission. New elements include three Executive Vice-Presidents (EVPs), who hold a double function as both coordinators of various policy areas, and direct responsibility for a specific policy via leading a dedicated Directorate General (DG). In addition to the three EVPs, there are five Vice Presidents, four of which will only have coordinating roles, and not lead a dedicated DG, and the remaining 18 Commissioners, all with at least one dedicated policy area for them to lead on.

Commission President VDL presented a first glance of her political guidelines for the next five years in July 2019. The political guidelines focus on six main ambitions for Europe for the coming five years:

- A European Green Deal
- An economy that Works for people
- A Europe Fit for the Digital Age
- Promoting our European way of life
- A Stronger Europe in the World
- A New Push for European Democracy

The six ambitions capture policy areas that VDL believes are necessary to address the needs and concerns of European citizens, and reflect the challenging nature of the current external operating environment.

To support each strategic ambition, the Commission is contemplating a range of specific measures, which may be put forward as legislative or non-legislative measures in the near future.

The EU and Taxation

Two EVPs and a Commissioner are responsible to advance policies on taxation. These are:

- EVP for "An Economy that Works for People": Valdis Dombrovskis (Latvian)
- EVP for "A Europe Fit for the Digital Age": Margrethe Vestager (Danish)
- Commissioner for Economy: Paolo Gentiloni (Italian)

Commissioner Gentiloni is responsible for running the various taxation policies and ongoing legislative initiatives and is supported by the DG for Taxation and Customs Union. EVP Dombrovskis is due to supervise the work done in the taxation policies more broadly. It is worth noting that EVP Vestager (who maintains in a dual capacity her role as Commissioner for Competition, and has been prominent for her application of EU State aid rules in the tax sphere) is tasked to oversee the digital taxation policies more specifically.

Tax matters have been gaining more and more political relevance and momentum over the past few years. The VDL Commission intends to remain at the forefront of the tax debate, both at an international and European level. Digital taxation and the role of taxation in the European Green Deal are central in the VDL mandate but four main priorities are particularly important.

Taxation of the Digital Economy

The EU has been one of the frontrunners in the debate around the taxation of the digital economy and the introduction of DSTs. Two legislative proposals were negotiated at the EU level under the Junker Commission.

However, due to the ongoing OECD deliberations on agreement a consensus-based solution for the taxation of the digital economy, it has been decided to stop the EU negotiations on the issue until the end of 2020, when (it is hoped) global consensus on the OECD proposals is envisaged.

That said, the VDL Commission has a clear political mandate to advance with its own proposal, should the OECD process fail to deliver a solution by the end of the year. With a further delay in the OECD negotiations increasingly possible, it is very likely that a renewed EU proposal could emerge in early 2021. For the time being, it is still unclear whether the EU plans to issue a revision of the existing proposals, or if it would propose an entirely new proposal.

Environmental Taxation

Driving the Green agenda and addressing climate change is a key ambition for the VDL Commission. One of the goals set out by the VDL Commission President is to achieve a carbon-neutral economy by 2050.

Various measures underpin this goal, including two important fiscal initiatives:

- Reviewing of the European Energy Tax Directive towards promoting environmentally sustainable technologies. The transport and maritime sectors are very likely to be impacted by this initiative.
- Proposing a World Trade Organization (WTO) compatible Carbon Border Adjustment Tax to address carbon leakage in view of the broader climate goals and ensure a level playing field between EU operators and importers. This is an interesting proposal that would, in effect, impose EU environmental standards on all imports to a Member State. The EU has promoted the proposal as ensuring a level-playing field; opponents have characterized it as simple tariff-protectionism.

Business Taxation

Successive Commissions have proposed various legislative proposals to amend the corporate taxation regime across the EU.

The most prominent (and comprehensive), the Common Consolidated Corporate Tax Base (CCCTB), which would set unified rules for corporations to calculate their taxable income, is still under negotiation. It remains a top priority, and the VDL Commission intends to invest heavily in trying to create some political momentum in the negotiations in the coming months. The Commission still faces a significant resistance and reluctance from numerous member states that remain reluctant to surrender any degree of sovereignty over their tax rules. Without changes to the decision-making process on tax matters at the EU level (for more on which see the section, Tax Efficiency), and even with them, the adoption of an EU CCCTB currently remains a remote possibility.

According to the Commission Work Program 2020, an initiative (e.g., a Communication) on "Business Taxation for the 21st Century" is expected to be published during the second quarter of 2020.

Tax Efficiency

A proposal to change the decision-making process on tax matters at an EU level from its current system requiring unanimous agreement of the 27 Member States to a Qualified Majority voting (QMV) system (requiring the agreement of at least 55% of Member States representing at least 65% of the total EU population) was put forward by the Juncker Commission.

The stated aim of adopting QMV was to ensure greater efficiency, and faster decision making, in EU tax matters. The issue of Member State subsidiarity in taxation remains a core principle of the EU, but it undoubtedly delays negotiations, and invariably results in proposals being dropped. This was a cause of great frustration to Commission President Junker.

Efforts to change the voting rules have been adopted as a priority for the VDL Commission. The Commission Work Program 2020 announced the plans to introduce an "Action Plan to fight tax evasion and to make taxation simple and easy" (also expected to be published during the second quarter of 2020). Legislative proposals are expected to accompany the Action Plan. While it is not yet clear what the Action Plan will contain, proposals to amend the voting rights on tax matters are likely to be reintroduced.

INTERNATIONAL: Global Trade (and Tax)

With a Phase One deal with China signed, and US implementation of the United States-Mexico-Canada Agreement complete, the Trump Administration turns its focus to Europe. Despite centuries of strong bilateral ties, significant tensions (including those over taxation) are returning to the forefront, teeing up some uncertainty in transatlantic relations that could remain for some time.

The US v. the UK

With the UK having left the EU on January 31, President Donald Trump and Prime Minister Boris Johnson have made a US-UK trade agreement a top priority. US Treasury Secretary Steve Mnuchin recently suggested that a bilateral trade agreement could be finalized by the end of 2020, and the two sides plan to take up talks as soon as possible, even as the UK continues talks with the EU on their future relationship.

But despite the optimism on both sides, significant hurdles remain:

- **Unilateral UK Digital Services Tax (DST)**

  The UK plans to proceed with a unilateral DST, due to come into force in April 2020. The US is concerned that the UK tax plan would unfairly discriminate against large US technology firms. It recently brought up US domestic trade procedures examining a similar proposal from France, coming to the brink of implementing retaliatory tariffs against French imports in the US. The US has pledged similar actions targeting DSTs across Europe, making an investigation targeting the UK's digital tax a possibility.

  President Trump has previously threatened to impose tariffs on British-made automobiles, including Jaguar, Land Rover and other luxury brands. While the US has not yet imposed these tariffs, officials have threatened to use them as retaliatory measures should the UK implement the aforementioned unilateral DST.

- **Pharmaceuticals**

  The US has urged the UK to reform the drug-pricing mechanisms of the National Health Service (NHS) to allow for the importation of more US pharmaceuticals. Given the national pride associated with the NHS, any reforms could be politically unsustainable for Prime Minister Johnson's government, particularly given the existing instability resulting from Brexit. The starting position (at least) for the UK government is firmly that the NHS is not up for discussion.

- **Huawei**

  The UK decided to allow Huawei into some portions of its next-generation 5G network despite prolonged and significant lobbying by the Trump Administration. These tensions represent one of the first big challenges to the "special relationship" enjoyed between the two countries. Some US senior officials – including Members of Congress – have called into question the integrity "Five Eyes" intelligence-sharing, suggesting this issue could remain at the forefront of bilateral talks going forward.

- **US Presidential Election**

  Trade is a politically complex issue, one that often garners little attention in a presidential election year. Despite this, Trump officials have eagerly awaited the opportunity to move forward with US-UK trade talks, and both sides have said they would like to secure an agreement by the end of 2020, an ambitious timeline.

  These negotiations have the strong support of the US Congress, with the caveat that senior lawmakers remain concerned with Brexit's impact on the Irish border. The depth of any US-UK bilateral deal will depend significantly on how the latter concludes its formal withdrawal from EU institutions.

  The further the UK pulls itself from EU institutions, the more flexibility it has to conclude a comprehensive agreement with the US – the UK and EU recently released their formal positions on a future trade deal, positions that were distant enough from each other to suggest an abrupt separation could be possible when this interim period concludes at the end of 2020. But if the UK remains linked to many of the same regulatory policies that have caused tensions in broader US-EU relations, progress on a comprehensive trade deal could be at risk.

Prime Minister Johnson is expected to visit the US in February, where both sides are expected to begin formally discussing a trade agreement. Both sides will be working hard toward a trade win that they can bring back to their respective populaces.

The US v. France (and beyond): More Digital Taxes

The US has long argued that France's proposed DST would unfairly target large US technology firms. Specifically, the plan would have imposed a 3% tax on revenues that companies earn from providing digital services to French citizens. As tensions escalated, the US threatened retaliatory tariffs on French goods, such as wine.

At the World Economic Forum in Davos, Switzerland, however, Presidents Trump and Macron announced an agreement where France would suspend its proposed digital tax through 2020 and the US would postpone its retaliatory tariffs. Both sides hope that the cessation of tensions will allow the countries to complete negotiations on a broader DST.

Globally, negotiations are continuing within the OECD for a framework to prevent multinational corporations (like Facebook, Amazon and Google) from shifting profits between countries to avoid taxes. While the US agrees that the OECD is the proper forum for negotiations (rather than on a bilateral basis), officials are concerned that its proposals could unfairly target the largest global technology companies, most of which are American.

The US v. the EU: Transatlantic Trade Tensions and Negotiations

The US and EU have for years discussed the possibility of a bilateral deal, bringing together two of the world's largest economies. During the Obama Administration, the two sides held talks on the Transatlantic Trade and Investment Partnership (T-TIP), a comprehensive agreement to eliminate tariffs, open markets, and reduce the costs of regulatory compliance on both sides of the Atlantic by increasing cooperation and cohesion of policies.

Upon taking office, President Trump ended the T-TIP talks. While both sides began the process of restarting negotiations for a new trade deal with the EU, those talks quickly hit a stalemate, as the two sides clashed over whether negotiations would include agriculture. Trade tensions continued to build, as President Trump repeated threats to impose tariffs on European autos and auto parts, and as a decades-long dispute over aircraft subsidies came to a head at the WTO, with the US authorized to impose retaliatory tariffs on billions worth of European exports.

After months of escalating tensions and progress at a stalemate, the two sides have entered 2020 with a renewed focus on advancing some sort of agreement as soon as possible. In October 2018, President Trump did notify Congress that he intended to enter into Free Trade Agreement negotiations with the EU (the same day he provided a similar notification regarding the UK and Japan). At the Davos World Economic Forum in January 2020, President Trump announced plans to conclude a deal as soon as this year. Given this ambitious timeline, the two sides are more likely to conclude a "mini-deal," similar to what the Trump Administration previously concluded with Japan and China, one that is limited only to certain areas of US-EU trade relations and that would not be subject to the detailed notice and consultation processes set out under US law for traditional trade agreements. Despite the air of optimism, President Trump continues to wave the threat of auto tariffs as an alternative, should an agreement not be reached, a position held by this Administration to use the threat of tariffs as a means of leveraging other policy goals.

The past three years of the Trump Administration have been intensely consequential for the international trading community. The Administration has unilaterally imposed tariffs on thousands of goods – around the world and against some of its biggest trading partners – in an effort to secure its policy goals. During this time, its focus has been mostly elsewhere across the globe, but the Administration has already signaled that many of its key priorities for the year – building bilateral US-UK trade ties after Brexit, addressing DSTs across national capitals and concluding a trade agreement with the EU – suggest the continent will be front of mind for months to come.

We Can Help

We have a dedicated team of leading tax experts to help you with issues arising in the world of taxation, from the challenges posed by the digitalization of the economy to global trade, international dispute resolution to policy development, implementation and effect. We can strategize and support your engagement with national governments, the European Commission and the OECD's Inclusive Framework on BEPS.

We look forward to engaging with you as your trusted adviser, as national and international tax law continues to evolve.

Contacts

Jose E. Aguilar Shea
Partner, Madrid
T +34 91 520 0751
E jose.aguilarshea@squirepb.com

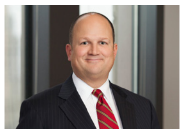
Linda Pfatteicher
Partner, San Francisco
T +1 415 954 0347
E linda.pfatteicher@squirepb.com

Bradford A. Clements
Associate, Palo Alto
T +1 650 843 3235
E bradford.clements@squirepb.com

Jeff VanderWolk
Partner, Washington DC
T +1 202 457 6081
E jeff.vanderwolk@squirepb.com

Frank R. Samolis
Partner, Washington DC
T +1 202 457 5244
E frank.samolis@squirepb.com

Christina Economides
Public Policy Advisor, Brussels
T +322 627 11 05
E christina.economides@squirepb.com



Mitch Thompson
Partner, Cleveland
T +1 216 479 8794
E mitch.thompson@squirepb.com

Matthew D. Cutts
Partner, Washington DC
T +1 202 457 6079
E matthew.cutts@squirepb.com

37087/02/20