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IRS Ruling on Attempted Check-the-Box Revocation Offers Cautionary Tale

A recent private letter ruling ([PLR 202123001](#)) addressed the 60 months' limitation rule that restricts an entity that changes its entity classification from making another election regarding its entity classification within 60 months of that election. In denying late election relief, the Internal Revenue Service (IRS) stated that allowing the second election would be tantamount to an unpermitted revocation of the original election. The ruling serves as a cautionary tale for other taxpayers who may be contemplating a change in entity status. Although PLRs are binding only on the taxpayer who requests the ruling and may not be cited as precedent, they offer an indication of IRS' position with respect to the issue and can be relied on in connection with certain types of penalty relief.

Cautionary Tale

In PLR 202123001, IRS denied a taxpayer's election to treat a foreign eligible entity as a corporation for federal income tax purposes. ABC was formed on Date 1 as a foreign eligible entity that was taxed as a corporation. On Date 2, a domestic investor acquired an ownership interest in ABC through a disregarded entity. As part of the acquisition, ABC sought advice regarding tax efficiencies between a potential controlled foreign corporation (CFC) status and a partnership structure. Based on this advice, ABC filed an entity classification election to change its entity classification to a partnership structure effective on Date 2.

By virtue of the ruling request, and after the entity classification election filed on Date 2, ABC sought relief for a late entity classification election to be treated as a corporation effective Date 2 and thus rescind the events of the prior transactions as if they never happened (i.e., revert to its original classification as a corporation as if it had never elected to be a partnership).

The taxpayer sought to file the rescinding and overlapping election in a different tax year than the partnership election. ABC reasoned that the regulations did not except rescinding or overlapping elections as the regulations state, "change during the 60 months succeeding the effective date", and ABC understood this to mean that elections effectuated on the effective date of the election would not trigger the 60 months' limitation rule countdown.

The Response

In denying the late election relief sought, IRS contended that the requested relief breached the current regulation's 60 months' limitation rule, which restricts an entity that changes its entity classification from making another election regarding its entity classification within 60 months of that election. IRS noted two limited exceptions to the 60 months' limitation rule. First, if more than 50% of the ownership interests of the entity as of the effective date of the subsequent election are owned by persons that did not own any interests in the entity on the filing date or effective date of the prior election, IRS may permit the entity to change its classification by election within 60 months. Second, when the first election by a newly formed eligible entity becomes effective on the date of formation, it is not considered a change for purposes of triggering the countdown for the 60 months' limitation rule.

The Internal Revenue Code (Code) and the regulations thereunder do not contemplate the use of rescinding or overlapping elections which IRS asserted are different from a second election. A taxpayer cannot have two elections effective on the same day since the deemed transaction of changing from a corporation to a partnership has already occurred. On the effective date of the election to be treated as a partnership, a deemed liquidation of the corporation had already occurred the day before the effective date. IRS asserted that to allow such an election would be tantamount to a revocation of the original election, which is not contemplated or permitted under the regulations as written. IRS further noted that recissions have other tax implications when they straddled different tax years and cited Rev. Rul. 80-58.

The Takeaway

IRS' recent private letter ruling on the 60 months' limitation rule for changes in entity classification sheds light on how IRS may rule with respect to other taxpayers seeking entity classification changes under similar circumstances. Changes that could be deemed revocations of an original election are generally not permitted. Potential election changes should be analyzed diligently in light of this development and approached with caution.

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New E-Commerce VAT Rules in the European Union

U. S. and other non-European Union (EU) distance sellers and marketplace facilitators with customers in the EU need to ensure they are prepared for new e-commerce Value Added Tax (VAT) rules that came into effect in each of the 27 EU member states on July 1, 2021.

VAT Generally

VAT is a transactional tax and is levied on practically all goods and services. Goods generally refer to tangibles and services refer to intangibles or more broadly anything that is not deemed to be a good. VAT applies throughout the supply chain on both business-to-business and business-to-consumer transactions, including the importation of goods and services, and intercompany supplies. A physical presence in a VAT jurisdiction is generally not required to be liable for VAT. However, for most businesses, VAT incurred on purchases, whether for resale or internal use is potentially refundable.

Nearly all countries outside the United States impose a VAT, also called Goods and Services Tax (GST) or Consumption Tax (CT).

New E-Commerce VAT Rules

Similar to the new sales tax regime in the U.S. following the *South Dakota v. Wayfair* decision, which adopted an economic nexus standard by means of sales thresholds without the requirement for some sort of establishment for local sales taxes, many countries with VAT apply rules simply deeming a particular sale transaction to take place in their jurisdiction, and therefore subject to VAT, irrespective of a physical presence. For example, in an effort to secure taxation in the jurisdiction of consumption, the EU introduced rules in 2003 that require non-resident providers of so-called electronically supplied services or digital services to register and collect VAT on sales of these online intangibles to consumers in those countries. Subsequently, an increasing number of countries around the world have enacted similar rules imposing an obligation to collect VAT on digital services provided by businesses that lack a physical presence within their borders. As with taxing intangible digital products, the EU countries have now abolished tax-free import thresholds for tangible products (i.e, goods) and introduced rules for non-residents to collect VAT at the point of sale on certain tangible products (i.e., goods) that are shipped from a different jurisdiction to consumers in the EU. Previously, these distance sales were generally structured such that applicable VAT on the goods was levied at importation and collected from the consumer as the importer of record, usually facilitated by the courier or postal service.

Under the new e-commerce VAT rules, the VAT due on these so-called low value consignments—which in the EU are defined as shipments of goods valued up to EUR 150—sold to consumers, can be collected by the non-resident distance sellers and marketplace facilitators from the EU consumer at the point of sale.

Although for the 27 EU member states a single EU-wide VAT registration and simplified VAT compliance is available, VAT is to be calculated at the rate applicable in the country of the consumer, and standard VAT rates currently range between 17% and 27%. It should be noted that the UK is no longer a member of the EU. However, similar rules came into effect in the UK when it transitioned out of the EU on January 1, 2021. Furthermore, Norway and Switzerland already impose an obligation on non-resident distance sellers of certain goods to collect VAT at the point of sale, and on the others side of the world Australia and New Zealand were the first to introduce these rules. Though the concepts in all of the jurisdictions are similar, thresholds and whether these apply per item or to entire consignments, and on which value, as well as compliance obligations differ and should be confirmed for each.

With the recently passed July 1, 2021 deadline, e-commerce businesses that have not done so already, should review their supply chain to understand the new VAT rules that apply to sales to consumers in the EU. Key action items for affected businesses include updating customer terms & conditions, obtaining VAT registrations and reviewing systems supporting their e-commerce platforms.

To comply with the new rules the customer order check-out page on the e-commerce platform should be able to capture information to calculate the appropriate amount of VAT as well as produce details required to be included on shipping documents for customs clearance purposes in the destination country. Businesses that sell via third party marketplaces should review agreements with those facilitators to confirm the obligation to collect VAT.

Failure to prepare and implement changes for the new rules may create significant exposure to a business and with VAT rates ranging up to 27%, not collecting VAT when required can reduce or erase profit margins. Furthermore, non-compliance may also disrupt order fulfillment, such as delays at importation and as such negatively impact the customer experience.

The Takeaway

The COVID-19 pandemic has caused a surge in online consumer purchases, and distance sellers with customers around the world should monitor local VAT developments as it is likely that more jurisdictions will follow with similar rules.

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SPACs and Tax Considerations for Investors, Sponsors and Target Companies

Special Purpose Acquisition Companies (SPACs) have received a lot of attention as lucrative investments, and ways for private companies to access public capital markets without the constraints of the typical IPO process. SPACs are "blank check" companies where SPAC founders (called Sponsors) form shell companies and raise capital through an initial public offering (IPO). The SPAC uses the IPO proceeds to acquire a target company in a particular industry or based on an investment thesis. The SPAC IPO proceeds are placed into trust, and the SPAC has a definite timeline to make an investment in a target company, typically 24 months. The process of the SPAC executing an acquisition and becoming an operating public company is often called a de-SPAC transaction.

Investors in SPACs acquire a share in the stock of the SPAC, and a fractional warrant to acquire additional stock in the SPAC. When a target company is identified, SPAC shareholders can decide to participate in the SPAC investment and exercise the warrant or not. If SPAC investors do not participate in the acquisition, they can receive the investment back, reduced for expenses incurred by the SPAC. Last year was a record year for SPAC IPOs with 237 SPAC IPOs raising nearly $80 billion of capital (according to a December 2020 Nasdaq article). Further, a first quarter 2021 analysis by PitchBook, indicates SPAC IPOs continue to outpace de-SPAC transactions, suggesting a continued appetite for SPAC investments and the presence of significant capital to be deployed for de-SPAC transactions in 2021-2023.

On April 12, 2021, the U.S. Securities and Exchange Commission (SEC) issued a joint statement to provide their view on the accounting treatment of warrants issued by SPACs. The statement suggests that the SEC staff has concerns that warrants issued by many SPACs should be properly accounted for under the liability method on the balance sheet. As such, the staff advises that companies with these outstanding warrants (whether SPACs or the combined company following a de-SPAC transaction) consider the need to amend previously-filed audited and unaudited financial statements.

Despite increasing popularity, SPACs remain complex investment vehicles, and there are several tax considerations for SPAC sponsors, investors, and potential target companies. Below is an overview of some of the tax considerations a de-SPAC transaction target, SPAC investor, or sponsor should consider.

Target Implications

Many de-SPAC transactions are structured as combinations of the target and SPAC, treated as tax deferred mergers under Sec. 368 or tax-free contributions under Sec. 351. These structures allow de-SPAC target shareholders to defer gain in exchange for SPAC stock, except to the extent of cash proceeds received.

An issue that arises in a merger is the requirement that the target company maintain Continuity of Business Enterprise (COBE), meaning the target company continues to operate its business immediately after the transaction. This requirement is normally easy to satisfy when the target merges into the SPAC, but if the SPAC could merge into the target, this requirement could be at risk because the target will not operate the SPACs business immediately after the acquisition. Direction of the merger is important to not jeopardize the tax deferred status of the de-SPAC transaction.

SPAC targets that are eligible for qualified small business stock (QSBS) treatment generally maintain the QSBS exclusion through the receipt of SPAC shares in a merger. Under the QSBS rules, exchanging QSBS shares in a tax deferred merger under Sec. 368 allows a QSBS shareholder to attach the QSBS exclusion to the shares received. When the SPAC shares are liquidated the shareholder uses the QSBS exclusion to reduce capital gains.

Pass-through entity SPAC targets may agree to a taxable acquisition, providing the SPAC with a fair market value in the tax basis of the target assets (a step-up). This step-up is valuable to the SPAC, providing future deductions to reduce cash taxes. As a result, the SPAC may try to induce the sellers into a taxable transaction by entering into a tax receivable agreement (TRA) where the sellers are contractually entitled to receive a portion of the cash tax savings arising from the step-up.

Acquirer Implications

The SPAC acquirer in a merger normally assumes the historical tax basis in the assets and tax attributes of the target. Depending on the structure of the transaction, the target's tax attributes may or may not be limited under Secs. 382 and 383. Sections 382 and 383 impose a limitation on the utilization of net operating loss, credit carryovers, and unrecognized losses of the target if there is a change in ownership. A change in ownership happens when a corporation has a cumulative owner shift of greater than 50% over a three-year period. Many de-SPAC transactions do not entail the SPAC acquiring greater than 50% of the value of a target. However, the de-SPAC transaction taken together with historical equity transactions of the target may result in an ownership change and limitation under Sec. 382.

Depending on the jurisdiction of the SPAC and jurisdiction of the target, there could also be cross-border tax implications of the de-SPAC transaction. A U.S. organized SPAC acquiring a foreign corporation would need to consider the anti-inversion rules of Secs. 7874 and 367.

SPAC Investor Considerations

Generally, the SPAC transaction does not present tax implications to the SPAC shareholder with respect to the share of SPAC stock, either because the SPAC is the acquirer, or the SPAC exchanges its stock for stock in the target in a Sec.

368 reorganization. However, de-SPAC transactions structured as tax deferred contributions under Sec. 351 can be problematic for the SPAC warrant. Transactions under Sec. 351 do not permit the exchange of warrants tax free. This may force the holder to exercise the warrant or may result in unforeseen tax consequences to the investor.

Sponsor Considerations

The management team that forms the SPAC is referred to as the Sponsor(s). In exchange for establishing the SPAC, the Sponsor is awarded founders shares, typically representing 20% of the SPAC shares. If the Sponsors shares are viewed as being received in exchange for services, a Sec. 83(b) election will be made to include the fair market value of those share as income at the time of grant. At the onset, the shares are presumed to have very little value. Any further appreciation will then be classified as a capital gain on exit. In some respect this mirrors carried interest as received by fund managers (i.e., a 20% allocation of capital gains). All economic arrangements should be carefully reviewed to determine if the carried interest rules under Sec. 1061 apply.

Special Considerations for Foreign SPACs

To allow flexibility to acquire targets globally, some SPACs are formed in tax favored jurisdictions such as the Cayman Islands. This allows the SPAC to acquire a foreign target without involving a U.S. corporation, and provides for a path to domesticate the SPAC if the target is U.S. Foreign SPACs with U.S. investors can have significant complexity if the SPAC is classified as a passive foreign investment company (PFIC). A PFIC acquiring a U.S. domestic corporation could create ordinary income to the SPAC investor under proposed regulations under Sec. 1291(f). Certain elections may mitigate this impact, but the exchange of SPAC warrants in a domestication transaction could also be a taxable event to the SPAC investors.

The Takeaway

There is a robust pipeline of SPAC IPOs and the potential for significant de-SPAC activity in 2021-2023. SPAC investors, Sponsors, target companies and target shareholders should understand the tax nuances in the SPAC structure and de-SPAC transaction, and avoid unintended tax consequences of the SPAC investment or target disposition.

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Tax Policy Update: Biden's 2021 Tax Proposals

The Biden administration's agenda and legislative priorities have increasingly become the focus of many seeking to understand and plan for potential tax changes on the horizon. Narrow Democratic margins in Congress mean the path to enactment may be challenging and that proposals may change significantly during the legislative process. In addition, given the limited Congressional calendar remaining for 2021, legislative activity could happen quickly so taxpayers should work closely with their tax advisors to understand the proposals as they develop and plan accordingly.

Background and Timeline

On March 11, 2021, President Biden signed the American Rescue Plan Act of 2021 into law. The $1.9 trillion package was intended to combat the COVID-19 pandemic, including public health and economic impacts. The legislation was primarily targeted at extending existing tax credits and offering additional tax relief to families and businesses affected by the pandemic. For further discussion see Andersen's Tax Release – American Rescue Plan Act Includes Tax Changes Affecting Businesses and Individuals.

Shortly after signing the American Rescue Plan Act of 2021, President Biden announced the American Jobs Plan, setting forth the first piece of the administration's infrastructure plan. To finance the spending plan, the Biden administration proposed the Made in America Tax Plan, which contains a number of provisions that would significantly increase taxes on corporate businesses and businesses with foreign operations. For further discussion see Andersen's Tax Release – President Biden's American Jobs Plan Includes Major Corporate Tax Changes; Tax Credits for Clean Energy and Domestic Manufacturing.

The business tax proposals were followed up with the American Families Plan on April 28, 2021, which proposed $1 trillion in investments and $800 billion in tax credits aimed towards children and families. To pay for the investments and credits, the plan contains a number of provisions targeting high-income individuals and increased IRS enforcement activity. For further discussion see Andersen's Tax Release – President Biden Proposes Tax Increases for Wealthy Individuals and Greater Funding for IRS Enforcement.

The Treasury Department subsequently issued its green book in May 2021 to provide additional details of the Made in America Tax Plan and the American Families Plan. Negotiations are expected to continue for several months and legislative text of the Biden administration's tax proposals may not be available until fall 2021. For further discussion see Andersen's Tax Release – U.S. Treasury Issues Green Book Providing Additional Details Regarding the Biden Administration's Tax Plans.

2021 Timeline for Tax Policy Actions

Please click this **link** to review the 2021 timeline.

Biden's Tax Proposals

Among the many components of the Biden tax plan is an increase in the top individual tax rate to 39.6% from 37%. Also included in the plan is a potential retroactive increase in the capital gains tax rate as of the date of announcement from its current 20% to 39.6% for those making more than $1 million a year. The plan would also repeal the step-up in basis for inherited assets for gains in excess of $1 million per person ($2.5 million for married couple when combined with the existing real estate exemption under Sec. 121) and apply the 3.8% Medicare tax to all income and earnings over $400,000. Income and gains received from carried interest would be taxed as ordinary income under the plan, and the limitation on excess business losses of noncorporate taxpayers under Sec. 461(l) would be permanently extended.

The Biden tax proposals also call for an increase in the corporate tax rate to 28% from 21% as well as a 15% minimum tax on the financial statement income of large multinational corporations. Tax preferences for the fossil fuel industry would be eliminated in favor of tax incentives for alternative energy resources. Significant changes are also proposed for many international tax provisions, generally with an aim to curtail some of the perceived benefits under the Tax Cuts and Jobs Act (TCJA) and further disincentivize U.S. taxpayers from moving business operations, investments and profits offshore. For further discussion on the international tax proposals see Andersen's Tax Release – Biden Administration's Green Book Details Proposed Changes to U.S. Foreign Income Tax Regime, New Reporting Requirements.

The proposals also implement new information reporting requirements with respect to accounts with financial institutions and transactions involving cryptocurrency targeted at improving tax compliance. Additional funding for IRS enforcement activity has also been proposed, with a focus on increased enforcement activities for wealthy individuals, estates, businesses, and large corporations.

For further discussion of the Biden administration's various tax proposals see Andersen's 2021 Policy Outlook, which details 2021 legislative activity and maps out planning considerations for the short-term, mid-term and long-term with an eye on key provisions of the Coronavirus, Aid, Relief, and Economic Security (CARES) Act, the TCJA, as well as the state of the economy. Check back often for updates on Andersen's Tax Policy and Legislative Updates page.

The Takeaway

If enacted, the Biden administration's tax proposals would result in significant changes to tax provisions affecting both individuals and businesses. However, it is unclear at this point whether all or a portion of the tax changes will be enacted into law. It is likely that policy components of the infrastructure plan, including changes in tax law, may change during the legislative process. Given the significant implications of the proposed changes, it is important to start considering them now and develop possible contingency plans to account for your personal and financial circumstances.

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