

31 July 2020

Global Tax Alert

Report on recent US international tax developments - 31 July 2020

NEW! EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration [here](#).

Also available is our [EY Global Tax Alert Library](#) on ey.com.

The United States (US) Treasury and the Internal Revenue Service (IRS) on 28 July released final regulations ([TD 9905](#)) and proposed regulations ([REG-107911-18](#)) on the business interest expense limitation under Internal Revenue Code¹ Section 163(j) (the Section 163(j) Limitation). The Section 163(j) Limitation was modified in December 2017 by the *Tax Cuts and Jobs Act* (TCJA), and in March 2020 by the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act).

At the same time, the IRS issued Notice 2020-59, which creates a safe harbor allowing taxpayers that manage or operate qualified residential living facilities to be treated as a real property trade or business solely for purposes of qualifying as an electing real property trade or business. The Government also released [FAQs](#) on the aggregation rules that apply for purposes of the gross receipts test and determining whether a taxpayer is a small business exempt from the Section 163(j) deduction.

The eagerly-anticipated final regulations provide guidance on:

- ▶ Items treated as interest expense and interest income for purposes of Section 163(j)
- ▶ The exclusion of certain small taxpayers and trades or business from the Section 163(j) Limitation
- ▶ The application of the Section 163(j) Limitation to consolidated groups, partnerships, foreign corporations, trusts and other taxpayers (such as REITs - real estate investment trusts)
- ▶ The interaction of Section 163(j) with other deferral, disallowance and capitalization rules
- ▶ Ordering rules for taking into account previously disallowed interest expense
- ▶ Elections for excepted trades or businesses and how to allocate interest expense, interest income and other items
- ▶ Coordination of the final regulations with the provisions of the CARES Act

There are significant changes in the final regulations, as compared to the former proposed regulations, including:

- ▶ Narrowing the proposed scope of the items treated as interest income and expense to exclude commitment fees, debt issuance costs, and gains/losses from certain hedging transactions, except in cases of abuse
- ▶ Permitting taxpayers to add depreciation, amortization or depletion allowances that are capitalized into inventory under Section 263A to “tentative taxable income” when calculating adjusted taxable income (ATI) for tax years beginning before 1 January 2022
- ▶ Precluding intercompany transactions and asset transfers to an acquiring corporation in a Section 381(a) transfer from being treated as a “sale or other disposition”

The final regulations apply to the first tax year beginning 60 days after the final regulations are published in the Federal Register (i.e., 1 January 2021, for calendar-year taxpayers). An anti-avoidance rule applies to transactions entered on or after the date the final regulations are published in the Federal Register. Taxpayers may apply the final regulations to tax years beginning after 31 December 2017, so long as they consistently apply all of the final regulations.

The Section 163(j) proposed regulations:

- ▶ Include a substantially modified set of rules for applying the Section 163(j) Limitation to controlled foreign corporations (CFCs), including CFCs that are members of a “CFC group”
- ▶ Clarify the application of Section 163(j) to different partnership structures
- ▶ Provide guidance under the CARES Act on excess business interest expense allocated to a partner in a partnership in a 2019 tax year, and the election to use ATI from the last tax year beginning in 2019 to determine a taxpayer’s Section 163(j) Limitation for a 2020 tax year
- ▶ Provide rules for applying the Section 163(j) Limitation to foreign persons with effectively connected income

The proposed regulations generally are not retroactive, though taxpayers may choose to apply them to tax years beginning after 31 December 2017.

The IRS will provide compliance resources to address taxpayers’ stock-based compensation in cost-sharing arrangements, according to IRS Large Business & International (LB&I) Division Commissioner Douglas O’Donnell. The action is being taken following the US Supreme Court’s recent denial of the petition for writ of certiorari in *Altera Corporation & Subsidiaries v. Commissioner*. The Commissioner was quoted this week as saying that LB&I would use its centralized transfer pricing risk assessment approach to identify and examine taxpayers that are found to have improperly reported their stock-based compensation expenses. The Commissioner added that LB&I would be working with the Office of the IRS Associate Chief Counsel (international) to “determine whether there’s a need for additional guidance with respect to a number of specific technical aspects that we realize are out there.”

Altera had filed the petition asking the Supreme Court to review a decision of the Ninth Circuit Court of Appeals upholding the 2003 version of Reg. Section 1.482-7, which requires participants to include stock-based compensation costs in a cost-sharing arrangement. The LB&I Commissioner acknowledged that Altera only applies within the jurisdiction of the Ninth Circuit but said “we do think it will help us generally in our cost-sharing cases and at Appeals,” and if the IRS litigates in the future.

Endnote

1. All “Section” references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP, International Tax and Transaction Services, Washington, DC

- ▶ Arlene Fitzpatrick arlene.fitzpatrick@ey.com
- ▶ Joshua Ruland joshua.ruland@ey.com

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2020 EYGM Limited.
All Rights Reserved.

EYG no. 005285-20Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [ey.com](#).

© 2015 EYGM Limited.
All Rights Reserved.

EYG no. xxxxxx
1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

[ey.com](#)